90-6 64

No. ______

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

QUALITY INNS INTERNATIONAL, INC.,
QUALITY HOTELS & RESORTS, INC. and
QUALITY INNS, INC.,
Petitioners
v.

L.B.H. ASSOCIATES LIMITED PARTNERSHIP and
FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondents

**Petition for Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

PETITION FOR WRIT OF CERTIORARI

DAVID F. ALBRIGHT *
FRANKLIN T. CAUDILL
SEMMES, BOWEN & SEMMES
250 W. Pratt Street
Baltimore, MD 21201
(301) 539-5040

* Counsel of Record
Counsel for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Did the Debtor-in-Possession's Chapter XI Plan comply with the Absolute Priority Rule required by the Bankruptcy Code, when the Debtor's principals infused no new value into the Debtor, but nevertheless were allowed to retain ownership interests, to the detriment of creditors whose claims were not fully satisfied?

PARTIES TO THE PROCEEDINGS

Petitioners and appellants below, Quality Inns, Inc., Quality Hotels & Resorts, Inc. and Quality Inns International, Inc., have a parent company, Manor Care, Inc., required to be listed pursuant to Rule 28.1.

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PETITION FOR WRIT OF CERTIORARI

Petitioners, Quality Inns International, Inc., Quality Hotels & Resorts, Inc. and Quality Inns, Inc., respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit, entered in the above entitled proceeding on July 26, 1990.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is unreported and is reprinted in the Appendix hereto ("App.") at 1a.

The opinion of the United States District Court for the District of Maryland (Niemeyer, J.) affirming the Bankruptcy Court is unreported and is reprinted at App. 17a. The unreported opinion of the Bankruptcy Court confirming the Plan of Reorganization is reprinted at App. 39a.

JURISDICTION

Proceedings under Chapter XI of the Bankruptcy Code were initiated in the United States Bankruptcy Court for the District of Maryland and jurisdiction is provided by 28 U.S.C. § 1334(a). The Bankruptcy Court confirmed a Plan of Reorganization. After a timely appeal, the District Court affirmed the decision of the Bankruptcy Court confirming the Plan of Reorganization. Thereafter the Fourth Circuit Court of Appeals affirmed the decision of the District Court.

The jurisdiction of this Court to review the judgment of the Fourth Circuit is invoked under 28 U.S.C. § 1254 (1).

PERTINENT STATUTORY PROVISION

Section 1129(b)(2)(B) of the Bankruptcy Code, 11 U.S.C. § 1129(b)(2)(B), provides in pertinent part:

> (b) with respect to a class of unsecured claims
>
> > (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
> >
> > (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such claim or interest any property.

STATEMENT OF THE CASE

The Debtor in this case owns and operates the Lord Baltimore Hotel in Baltimore, Maryland. After conducting renovations, the Debtor reopened the Hotel in 1986 but immediately experienced financial difficulties. By September 1987, the Debtor's condition had deteriorated to a point that it sought protection under Chapter XI of the Bankruptcy Code.

After extensive litigation, the Bankruptcy Court approved the Debtor's Third Amended Plan of Reorganization, on December 9, 1988. One key provision of the Plan was that the general partners of the Debtor (holders of "Class 7" and "Class 14" creditor claims) were allowed to retain their ownership interests despite the fact that claims superior to theirs had not been fully paid. Among those claims were the "Class 10" unsecured interests of the Petitioners.

Even though Class 10 creditors were clearly impaired as a class, the Plan provided that Class 14 interests, the owners of the partnership, i.e., the general partners, would "retain" their general partnership interests in the Debtor by either a reduction of their Class 7 claims by the application of a certain formula or, at the option of the Class 14 members, a cash contribution in accordance with a certain specified formula or a combination of cash or reduction of their Class 7 claims, all at the option of the members of Class 14.

The Plan did not require the contribution of any cash by the Class 14 members in order for the general partners to retain their general partnership interests in the Debtor. In contrast, the limited partnership interests, i.e., the Class 15 members, were required to contribute cash in order to retain their interests.

It was the contention of the Petitioners in the courts below that the confirmed Plan did not satisfy the Absolute Priority Rule as codified in the Bankruptcy Code, 11

U.S.C. § 1129(b)(2)(B). The Plan was confirmed despite the objections of the Petitioners that the Absolute Priority Rule was violated by the Plan, with the result that the equity owners of the Debtor were able to retain their junior equity interests without full payment of each objecting class of creditors (including Class 10).

REASONS FOR GRANTING THE WRIT

I. THE PLAN DOES NOT COMPLY WITH THE ABSOLUTE PRIORITY RULE

The issue presented here is one of the most important single issues raised by the Bankruptcy Code, both from a legal, equitable and fairness standpoint, and from the point of practical construction of the Code. The Absolute Priority Rule basically states, and has its most significant application in, the concept that the equity owner of a Chapter XI Debtor cannot retain any part of his interest unless all creditors or interests superior to him have been paid in full. The reason behind this Rule is obvious; both the courts and the drafters of the Code have shown a distaste for Chapter XI proceedings in which the same owners that created the Debtor's insolvency would be able to place the Debtor in Chapter XI, reduce the claims of the creditors, and end up retaining the ownership of the Debtor.

The practical importance of this issue is simply enormous in the efficient administration of the Bankruptcy Code. A breakdown in the application of the Absolute Priority Rule, or the use of innumerable exceptions that essentially eliminate the Rule, will cause not only unfairness to creditors but will also create a climate and an atmosphere conducive toward prolonging Chapter XI proceedings, toward increasing the number of Chapter XI filings, and toward encouraging the creation of complex imaginative mechanisms to avoid the effect of the Rule. For it is the very Debtor who proposes the Plan and has certain rights under the Bankruptcy Code to promote its

Plan during an exclusive time period that can benefit itself at the expense of the creditors if the Absolute Priority Rule is not properly applied.

The Debtor in this case is simply another partnership Debtor holding real property which has failed and has sought Chapter XI, like many other real property ventures throughout the United States. When one strips aside all of the various complexities in the Plan, the result is that the owners retain an equity interest in the Debtor and retain control of the Debtor without paying senior creditors 100 percent on their claims. There is no requirement in the Plan for the owners to put new cash into the Plan to secure and retain their ownership of the Debtor.

The Plan which was confirmed by the Bankruptcy Court is not fair and equitable to the Petitioners. Section 1129 (b) (2) (B) provides that in order for a plan to be considered to be fair and equitable

> (b) with respect to a class of unsecured claims
>
> > (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
> >
> > (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such claim or interest any property.

11 U.S.C. § 1129 (b) (2) (B)

In the Plan at issue, Class 14 provides that the general partners are permitted to retain their general partnership interest in the Debtor:

> by receiving five Partnership Units in exchange for, at their option,
>
> > (i) reduction of their Class 7 claims by $262,500.00;

(ii) a cash contribution of $262,500.00 to be made on or before the Effective Date; or

(iii) any combination of cash or reduction of the Class 7 claims at the rate of $52,500.00 for each Partnership Unit retained.

Thus the General Partners are able to retain an interest in the Debtor junior to the Petitioners' unsecured claims while the Petitioners' unsecured claims are not being paid in full.

Debtor proposes to permit the general partners to retain their interest in the Debtor by merely setting off claims against the Debtor. Since the Plan provides for payment of these claims over time, the contribution proposed by the Plan is not a contribution of new money or money's worth within any arguable exception to the Absolute Priority Rule.

The issue raised by this Petition is whether the particular Plan in question satisfies the Code, as interpreted by the Supreme Court, and to define the limits of the Absolute Priority Rule. A further definition of the Absolute Priority Rule, particularly as set forth in the Bankruptcy Code, will resolve an important bankruptcy issue and aid in the effective administration of bankruptcy cases.

The Bankruptcy Code itself does not provide for any exception to the Rule. It does not even provide for an exception covering the infusion of additional cash. That purely judge-made exception itself was recently questioned in the Brief for the United States as *amicus curiae* in *Norwest Bank Worthington v. Ahlers*, 108 S.Ct. 963, 967, Footnote 3 (1988). Even if the alleged exception is valid, this Court should rule that only cash or money generated from outside funds coming into the bankruptcy proceeding, thus adding value to the bankruptcy proceeding as a whole, is the extent of the exception permitted by the Code. Such an interpretation would permit *Case v. Los*

Angeles Lumber Products Co., 308 U.S. 106, 60 S.Ct. 1 (1939) to have continued validity but circumscribed properly to those areas where additional money comes into the bankruptcy proceeding from outside funds and where it is not merely a complicated readjustment of claims, waivers of claims, etc. to create an aura or image of "funding" when nothing of the kind is actually happening. The Court should not permit or encourage bankruptcy debtors to rebuild their previous house of cards with yet another house of cards sanctioned by the Bankruptcy Court.

This Court, in *Norwest Bank Worthington v. Ahlers*, *supra*, rejected a plan in which future services by the debtor were attempted to be likened to new money within the meaning of the so-called exception to the Absolute Priority Rule. This Court reversed that attempt to change the Absolute Priority Rule, noted the legislative history supporting its decision, and further noted that attempts had been made during the legislative process to water down the Absolute Priority Rule. It is submitted that it is in the utmost interest of the Bankruptcy Code to define the extent to which the Absolute Priority Rule is affected or curtailed by the alleged new money exception, to determine the extent to which that exception still exists, and to set forth whether or not this particular Plan qualifies under the Absolute Priority Rule set forth by the Code or by the law in existence at the time of the enactment of the Code.

II. DIFFERING INTERPRETATIONS OF THIS COURT'S DECISIONS HAVE LED TO CONFUSION AND CONFLICTING RESULTS IN THE LOWER COURTS

This Court has twice addressed the issues implicated by the present Petition. In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S.Ct. 1 (1939), long prior to the adoption of the Code, the Court stated in dicta that an equity holder could contribute "money or money's

worth" to an insolvent debtor, and thereby retain an ownership interest under a plan of reorganization. 308 U.S. at 121-22, 60 S.Ct. at 10.

More recently, after codification of the Absolute Priority Rule in the Bankruptcy Code of 1978, this Court decided *Norwest Bank Worthington v. Ahlers*, 108 S.Ct. 963 (1988). Therein, this Court suggested that any exceptions to the Absolute Priority Rule were eliminated by the passage of Code provisions, which incorporated the Rule without any such exceptions. *Id.* at 967 n.3. However, the Court did not decide the issue, since in any event the mere provision of future services could not constitute "money or money's worth", even though they undoubtedly had "value". *Id.* at 967. Indeed, the actual holding in *Los Angeles Lumber* was to the same effect, as the future efforts pledged by the equity owners there were not "money or money's worth". 308 U.S. at 122, 60 S.Ct. at 10.

Lower courts have interpreted these authorities in a variety of ways. Some courts have held that the *Los Angeles Lumber* exception is still valid, while generally finding that its requirements were not met in a particular case. *See, e.g., In re Blankemeyer*, 861 F.2d 192, 194 (8th Cir. 1988). Other cases note that the "money or money's worth" exception may or may not be valid, but hold that a particular debtor has not satisfied it. *See, e.g., In re Stegall*, 865 F.2d 140, 142-44 (7th Cir. 1989). Still other courts have read the Court's discussion in *Ahlers* as ruling out any "money or money's worth" exception; however, on their particular facts, these cases tend to hold that such an exception would not apply in any event to the facts in question. *See, e.g., In re Drimmel*, 108 Bankr. 284, 288-90 (Bankr. D. Kan. 1989); *In re Winters*, 99 Bankr. 658, 661-62 (Bankr. W.D. Pa. 1989). Indeed, the most notable aspect of all these rulings is the strictness with which the courts have interpreted the alleged "money or money's worth" exception; only the decisions below in

this case have allowed the alleged exception to be satisfied by anything other than an actual infusion of capital.

Certainly, the frequency with which the alleged "money or money's worth" exception is being litigated strongly suggests the need for guidance from this Court, especially in view of the varying results reached by the lower courts. Even if such an exception exists, the decisions below in this case stand in sharp contrast to the strict interpretations of other courts and this Court, and the judgment of the Court of Appeals should be reviewed in order to resolve this conflict.

CONCLUSION

For each of the foregoing reasons, this Court should grant the writ and reverse the decision below.

Respectfully submitted,

DAVID F. ALBRIGHT *
FRANKLIN T. CAUDILL
SEMMES, BOWEN & SEMMES
250 W. Pratt Street
Baltimore, MD 21201
(301) 539-5040
Counsel for Petitioners

October 23, 1990

* Counsel of Record

APPENDICES

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2443

QUALITY INNS INTERNATIONAL, INC.;
QUALITY HOTELS AND RESORTS, INC.; and
QUALITY INNS, INC.,
Plaintiffs-Appellants,

versus

L.B.H. ASSOCIATES LIMITED PARTNERSHIP,
Defendant,

FEDERAL DEPOSIT INSURANCE CORPORATION,
Appellee.

No. 89-2444

QUALITY INNS INTERNATIONAL, INC.;
QUALITY HOTELS AND RESORTS, INC.; and
QUALITY INNS, INC.,
Plaintiffs-Appellants.

versus

L.B.H. ASSOCIATES LIMITED PARTNERSHIP,
Defendant-Appellee,

FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendant.

No. 89-2445

QUALITY INNS INTERNATIONAL, INC.;
QUALITY HOTELS AND RESORTS, INC.; and
QUALITY INNS, INC.,
Plaintiffs-Appellants,

versus

L.B.H. ASSOCIATES LIMITED PARTNERSHIP,
Defendant-Appellee,

FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendant.

Appeals from the United States District Court
for the District of Maryland, at Baltimore
Paul V. Niemeyer, District Judge

(CA-89-814-PN; CA-89-811; CA-89-643)

Argued: April 4, 1990 Decided: July 26, 1990

Before ERVIN, Chief Judge, SPROUSE, Circuit Judge, and SMITH, United States District Judge for the Eastern District of Virginia, sitting by designation.

Affirmed by unpublished per curiam opinion.

ARGUED: David Foxwell Albright, SEMMES, BOWEN & SEMMES, Baltimore, Maryland, for Appellants. Irving Edward Walker, FRANK, BERNSTEIN, CONAWAY & GOLDMAN, Baltimore, Maryland; Paul M. Nussbaum, WHITEFORD, TAYLOR & PRESTON, Baltimore, Maryland, for Appellees. ON BRIEF: Richard M. Kremen, Katharine M. Ebersberger, SEMMES, BOWEN & SEMMES, Baltimore, Maryland, for Appellants. Diana G. Motz, Kenneth Oestreicher, FRANK, BERNSTEIN, CONAWAY & GOLDMAN, Baltimore, Maryland; F. Gillis Green, WHITEFORD, TAYLOR & PRESTON, Baltimore, Maryland, for Appellees.

Unpublished opinions are not binding precedent in this circuit. See I.O.P. 36.5 and 36.6.

PER CURIAM:

Appellants Quality Inns International, Quality Hotels and Resorts, and Quality Inns (hereinafter "Quality") appeal the district court's affirmance of the bankruptcy court's disposition of various matters arising in the course of appellee L.B.H. Associates Limited Partnership's bankruptcy proceedings under Chapter 11.

L.B.H.'s sole asset was the Lord Baltimore Hotel, operated under a Management Contract and Franchise Agreement with Quality. On September 28, 1987, L.B.H. filed a bankruptcy petition in the United States Bankruptcy Court for the District of Maryland. On the same day, L.B.H. moved to terminate the Management Contract and Franchise Agreement. The bankruptcy court approved the termination by order of February 22, 1988.

On May 25, 1988, L.B.H. filed its first reorganization plan, but it did not file an accompanying disclosure statement. Quality filed a proposed reorganization plan and

disclosure statement on June 20, 1988. However, on July 7, 1988, the bankruptcy court granted L.B.H.'s motion to extend the time in which it had the exclusive right to file a plan, and the court struck Quality's plan in order to implement L.B.H.'s extension.

L.B.H. filed a Third Amended Plan of Reorganization on October 21, 1988, and the bankruptcy court confirmed the plan by order of December 9, 1988. Quality appealed to the United States District Court for the District of Maryland, and the district court affirmed by order dated June 21, 1989. This appeal followed.

I.

On appeal, Quality raises the following issues: (1) whether L.B.H.'s disclosure statement satisfied the requirements of 11 U.S.C. § 1125; (2) whether the bankruptcy court erred in extending L.B.H.'s exclusive filing period and in striking Quality's proposed plan and disclosure statement in order to implement the extension; (3) whether the bankruptcy court erred in failing to hear testimony concerning Saul Perlmutter's history as managing general partner of L.B.H. when L.B.H.'s plan proposed that Perlmutter remain with the hotel in a managerial capacity; (4) whether L.B.H.'s plan complied with the requirements of the bankruptcy code regarding the absolute priority rule and feasibility; (5) whether the bankruptcy court erred in overruling Quality's objection to the Federal Deposit Insurance Corporation's claim in the amount of $18,272,314.25; and (6) whether the bankruptcy court erred in approving L.B.H.'s termination of the Management Contract and Franchise Agreement. We address these issues in the order in which they are raised.

II.

A. *Disclosure*

Quality first asserts that L.B.H.'s disclosure statement did not satisfy 11 U.S.C. § 1125(a)(1), which requires disclosure of:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan. . . .

Quality contends that L.B.H.'s disclosure statement was inadequate because it did not disclose conflicts of interests and mismanagement by Saul Perlmutter, L.B.H.'s managing general partner, and did not disclose the new management's failure to meet growth projections.

After lengthy argument during which Quality raised each of these objections, the bankruptcy court approved L.B.H.'s disclosure statement. Joint App. at 565-71 (transcript of Aug. 30, 1988, hearing on objection to disclosure statement). Noting that these matters would be fully considered at the confirmation hearing, the court stated:

> I don't think that the Debtor is obligated to put in all of the negative views about its organization that the opposing parties may have. Obviously, they hold those views. They're here to express them and they'll be here probably to express them at confirmation, but I don't think the Debtor is obligated to supply the dagger that will end the Debtor's life before the confirmation is even embarked upon.

Id. at 571. The district court affirmed the bankruptcy court's conclusion of adequate disclosure. *Id.* at 1071-74

(transcript of district court's oral opinion of June 15, 1989).*

The adequacy of a disclosure statement is determined on a case by case basis in light of the particular facts and circumstances. *In re Scioto Valley Mortgage Co.*, 88 B.R. 168, 170 (Bankr. S.D. Ohio 1988). In this case, we find that the bankruptcy court did not err in its conclusion that adequate disclosure did not require the debtor to include all complaints raised by the debtor's opponents. Therefore, the district court was correct in affirming the bankruptcy court's conclusion in this regard.

B. *Exclusive Filing Period*

Quality next asserts that the bankruptcy court erred in extending L.B.H.'s exclusive filing period and in striking Quality's plan and disclosure statement. Section 1121(b) of Title 11 provides that "only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter." However, Section 1121(d) states that "the court may for cause reduce or increase the 120-day period."

On January 25, 1988, L.B.H. moved to extend its exclusive filing period. The bankruptcy court granted the extension because L.B.H. had been involved in protracted litigation to dissolve the management and fran-

* The district court also found that Quality was not harmed by any inadequacy because it knew the facts and was not induced to vote for or against the plan on the basis of the disclosure statement. Joint App. at 1071. In addition, the district court noted that it was "probably" correct that Quality lacked standing to raise the inadequacy of the disclosure statement on behalf of other creditors. *Id.*; *see In re Middle Plantation*, 47 B.R. 884, 891 (E.D. Va. 1984) ("Holders of impaired claims who have been induced to vote in favor of a plan are the only ones who may raise the issue of the adequacy of the Disclosure Statement."), *aff'd*, 755 F.2d 928 (4th Cir. 1985). In light of our holding that the district court did not err in affirming the bankruptcy court's conclusion of adequate disclosure, we do not reach these issues.

chise relationships with Quality, the case was a complex one, L.B.H. had "been making every effort to rehabilitate itself," and there was "a promise of success." Joint App. at 438-39 (transcript of July 5, 1988, ruling on motion to extend exclusive filing period). By order of July 7, 1988, the bankruptcy court also granted L.B.H.'s motion to strike Quality's plan and disclosure statement in order to implement the extension of L.B.H.'s exclusive filing period. The district court affirmed. *Id.* at 1074-48 (transcript of district court's oral opinion of June 15, 1989).

The bankruptcy court did not abuse its discretion in extending L.B.H.'s exclusive filing period. Section 1121(b) expressly authorizes such an extension, and the factors considered by the bankruptcy court are both relevant and permissible. Moreover, to the extent that the considerations relied upon by the bankruptcy court are findings of fact, they are not clearly erroneous.

Nor did the bankruptcy court abuse its discretion in striking Quality's plan, as that was the only means by which to implement the extension of L.B.H.'s exclusive filing period. In addition, because Section 1125(a)(1) provides that adequate disclosure need not include information about any other plan, the striking of Quality's plan did not render L.B.H.'s disclosure inadequate.

C. *Perlmutter Testimony*

Quality also maintains that the bankruptcy court erred in failing to hear testimony concerning Saul Perlmutter's alleged self-dealing as managing general partner of L.B.H., when L.B.H.'s plan proposed that Perlmutter remain with the hotel in a managerial capacity. When a principal of the debtor is to continue managing the debtor after confirmation, evidence of the principal's past performance is relevant to the confirmation decision. *In re Gulph Woods Corp.*, 84 B.R. 961, 974 (Bankr. E.D. Pa. 1988). To that end, the bankruptcy court heard testimony concerning Perlmutter's alleged conflicts of in-

terest, and Quality cross-examined him at some length on these points. Joint App. at 715-23 (transcript of Nov. 1, 1988, testimony of Saul Perlmutter).

However, we do not find that the bankruptcy court abused its discretion in limiting some aspects of this testimony. As the bankruptcy court noted during the confirmation hearing:

> I don't want Mr. Perlmutter to be the central issue in this case. I think the question is whether this plan that is before me will work out. To some extent the question will certainly devolve around whether the management that is in there is going to be successful, but I don't want this to degenerate into the kind of situation where we place one individual on trial and then he has got to come back and say he is a good person. That isn't the issue.

Supp. App. at 2 (transcript of Oct. 24, 1988, confirmation hearing). The bankruptcy court did not abuse its discretion in seeking to avoid undue emphasis on personalities at the expense of the relevant issues in the case.

D. *Absolute Priority Rule and Feasibility*

Quality next contends that L.B.H.'s plan did not comply with the requirements of the bankruptcy code regarding the absolute priority rule and feasibility. The absolute priority rule provides that a plan is fair and equitable with respect to a class of unsecured claims if "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of* such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

Under L.B.H.'s plan, Class 10 consists of Quality's unsecured claims. These claims are to be satisfied over time. Because no interest is to be paid, Quality asserts that the claims will not be paid in full. Class 14, junior

to Class 10, consists of L.B.H.'s general partnership interests. The plan provides that Class 14 claimants may retain their interests by receiving five partnership units in exchange for reduction of their Class 7 claims by \$262,500.00, contribution of cash in the amount of \$262,500.00, or any combination of cash and reduction of Class 7 claims in the amount of \$52,500.00 for each unit retained. Joint App. at 599 (Debtor's Third Amended Plan of Reorganization).

Quality maintains that the Class 14 claimants retain their junior interests on account of the Class 10 claims not being paid in full, in violation of the absolute priority rule. We disagree. The Class 14 claimants receive five partnership units in exchange for a contribution of capital in the amount of \$262,500.00, not on account of the Class 10 claims failing to be satisfied in full. Because the Class 14 claimants must make a current contribution of "money or money's worth" to retain their interests, *see Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 121-22 (1939), and because these contributions are necessary to the success of the undertaking, *see* Joint App. at 874-78 (projected cash flow statements), the plan does not violate the absolute priority rule.

Section 1129(a)(11) of Title 11 provides that a plan shall be confirmed only if confirmation is not likely to be followed by liquidation of the debtor or the need for further financial reorganization. The standard for feasibility is whether there is a "reasonable assurance of success. Success need not be guaranteed." *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir.), *cert. denied*, —— U.S. ——, 109 S. Ct. 176 (1988).

Feasibility is a factual determination subject to the clearly erroneous standard on appeal. *See, e.g., In re Acequia, Inc.*, 787 F.2d 1352, 1358 (9th Cir. 1986); *United Properties, Inc. v. Emporium Department Stores, Inc.*, 379 F.2d 55, 63-64 (8th Cir. 1967). After a confirmation hearing running from October 24, 1988, to

December 5, 1988, and involving numerous witnesses, eight of whom were experts, the bankruptcy court found that confirmation of L.B.H.'s plan was not likely to be followed by liquidation or the need for further reorganization, a finding affirmed by the district court. Joint App. at 1090-91 (transcript of district court's oral opinion of June 15, 1989). In light of the extensive confirmation hearing and the bankruptcy court's opportunity to evaluate the demeanor and credibility of the witnesses, we do not find its determination of feasibility to be clearly erroneous.

E. *FDIC Claim*

Quality next objects to the bankruptcy court's allowance of the Federal Deposit Insurance Corporation's claim. The FDIC filed a proof of claim in the amount of $16,690,287.10 on February 3, 1988. *Id.* at 117. After lengthy negotiations, the FDIC agreed to forgo substantial payments at the outset of the plan in exchange for payment of its claim in the sum of $18,272,314.25, and participation in L.B.H.'s litigation recoveries. *Id.* at 345-46, 613, 622, 626-28.

Quality objected to the FDIC's claim on November 2, 1988, and on November 21, 1988. Despite the objection, the bankruptcy court confirmed the plan on December 9, 1988. The court heard argument on the objection on January 24, 1989, and overruled the objection by order of the same date. The district court affirmed. *Id.* at 1081-85 (transcript of district court's oral opinion of June 15, 1989).

Quality first contends that confirmation of the plan was improper because the bankruptcy court had not yet ruled on Quality's objection. We disagree. Although the bankruptcy court did not actually rule on Quality's objection until January 24, 1989, the court addressed and rejected the objection in reaching its confirmation decision. *Id.* at 849-50 (transcript of Dec. 5, 1988, confirma-

tion hearing). Therefore, even if the bankruptcy court erred in confirming the plan prior to a formal ruling on Quality's objection, the error was harmless.

Quality also asserts that the FDIC failed to present evidence supporting its $18,272,314.25 claim. The bankruptcy court found that "[t]he amount is consistent with the evidence which was presented at the hearing on confirmation. It is consonant with the papers which are on file." *Id.* at 916 (transcript of Jan. 24, 1989, evidentiary hearing). Because Quality has failed to specify in what respects the larger sum is inconsistent with the evidence, and our review of the record indicates that the bankruptcy court's factual finding is not clearly erroneous, we affirm the judgment below in this regard.

Quality's last argument regarding the FDIC's claim is that the bankruptcy court erred in not subordinating the claim due to the FDIC's conduct. The doctrine of equitable subordination is codified at 11 U.S.C. § 510(c). Subordination is appropriate when the claimant has engaged in inequitable conduct, the conduct has injured creditors or given the claimant unfair advantage, and subordination is not inconsistent with the bankruptcy code. *See, e.g., Benjamin v. Diamond*, 563 F.2d 692, 700 (5th Cir. 1977).

With respect to the FDIC's claim, the bankruptcy court stated:

> [I]f ever there was an instance where the doctrine is inapplicable, it would be in this particular case. I can't see how there can be any subordination of the claim of FDIC when based on what I have seen throughout this proceeding it has operated absolutely magnificently, in good faith, with clean hands in negotiations which were conducted at arms length with the debtor and during which time in many cases as I indicated earlier to my surprise the FDIC has dealt away its advantage to the benefit of the debtor.

Joint App. at 916 (transcript of Jan. 24, 1989, evidentiary hearing). Because the bankruptcy court correctly applied the law and its findings of fact are not clearly erroneous, we find no error in the failure to subordinate the FDIC's claim.

F. *Termination*

Quality's final arguments concern the bankruptcy court's approval of L.B.H.'s termination of the Management Contract and Franchise Agreement. Article VII of the Management Contract provided:

> [I]f at any time during the Operating Term, after the exhaustion of the $768,000.00 of initial working capital, Owner has funded deficits in working capital and/or paid debt service on Permitted Financing from the Working Capital and Debt Service Reserve Account, hereinafter defined, in the total amount of at least $1,900,000.00, then Owner may terminate this Agreement by giving Operator thirty (30) days prior written notice of termination; provided, however, that Operator, at its option, exercisable by written notice to Owner within said thirty (30) day period, may avoid such termination of this Agreement by contributing, in cash, to the Working Capital Reserve Account an amount equal to the working capital furnished to the Operator from the said Working Capital Reserve Account during the period of twenty-four (24) months immediately preceding the Owner's notice of termination.

Id. at 60. An addendum to the Franchise Agreement provided that "if the Management Agreement is terminated by Owner for cause or pursuant to the second paragraph of Article VII, then Franchisee shall have the option of terminating the Franchise Agreement concurrent with the termination of the Management Agreement." *Id.* at 100.

Quality first asserts that the bankruptcy court erred in approving termination because L.B.H. did not meet the

funding requirements of Article VII. In its Order Approving Termination of Debtor's Management Contract with Quality Hotels and Resorts, Inc. and Franchise Agreement with Quality Inns International, Inc., dated February 22, 1988, the bankruptcy court found that:

> Prior to September 29, 1987, when LBH gave Quality Hotels notice of termination of the Management Contract, LBH had provided $768,000 for initial working capital and $3,802,359 for additional working capital and debt service, all of which was exhausted. . . . The Management Contract expressly permitted LBH to fund the hotel's working capital requirements and pay debt service from more than one bank account, and from sources other than bank accounts. That all of the funds were not transferred to the Hotel through specific bank accounts is immaterial.

The district court affirmed these findings. Joint App. at 1092-93 (transcript of district court's oral opinion of June 15, 1989).

The bankruptcy court's factual determination that L.B.H. contributed $3,802,359.00 toward working capital and debt service in addition to $768,000.00 in initial working capital is not clearly erroneous. *See, e.g., id.* at 239-40 (owner funding of initial working capital of $768,-000.00), 243-56 (transcript of Oct. 14, 1987, hearing on preliminary and permanent injunction). Therefore, the district court properly affirmed this finding. In light of this finding that L.B.H. provided the requisite level of funding, we do not address whether the bankruptcy court erred in its legal conclusion that the funds need not have passed through a specific account, because any error in this regard is harmless.

Quality also argues that the termination was improper because L.B.H. did not comply with the funding schedule established in Article XIII of the Management Contract. *See id.* at 65. However, Article VII allowed L.B.H. to

terminate the contract if it had contributed $1,900,000.00 toward working capital and debt service at "*any time* during the Operating Term." *Id.* at 60 (emphasis added). Therefore, compliance with the funding schedule was not a condition precedent to L.B.H.'s right to terminate.

Alternatively, Quality insists that L.B.H. was required to prove its own performance, including compliance with the funding schedule, as a condition precedent to termination. Such is generally the rule. *See Hubler Rentals, Inc. v. Roadway Express, Inc.*, 637 F.2d 257 (4th Cir. 1981). However, *Hubler* makes clear that nonperformance bars recovery only when a contractual duty is a condition precedent to recovery and the nonperformance would constitute a material breach. *See id.* at 260-61. As discussed above, compliance with the funding schedule was not such a condition precedent. Moreover, in the case at bar, an implied requirement that L.B.H. comply with the funding schedule would contradict the express terms of Article VII, which provided for termination after contribution of $1,-900,000.00 in working capital or debt service at "*any time* during the Operating Term." Joint App. at 60 (emphasis added). Finally, nothing in the record indicates that Quality considered L.B.H. to be in breach until L.B.H. sought to terminate the contract, nearly two years after any failure to comply with the funding schedule.

Quality next asserts that L.B.H.'s letters dated September 29, 1987, purported to terminate the Management Contract and Franchise Agreement immediately, in violation of the requirement that L.B.H. give Quality thirty (30) days' notice. We agree that the letters attempted immediate termination of these arrangements. However, any error in this regard was harmless. The purpose of the notice requirement was to allow Quality to avoid termination by contributing additional funding. *See id.* In its order approving termination of the Management Contract and Franchise Agreement, dated February 22, 1988, the bankruptcy court found that Quality "failed to tender

to LBH any cash to avoid termination prior to the expiration of the 30-day period." *Id.* at 340. This finding was affirmed by the district court. *Id.* at 1094 (transcript of district court's oral opinion of June 15, 1989). This finding is not clearly erroneous, and because Quality did not seek to exercise its right to avoid termination, any error regarding the notice requirement was harmless.

Lastly, Quality asserts that termination of the Management Contract and Franchise Agreement was not in L.B.H.'s sound business judgment. Under the business judgment rule, courts defer to corporate officers' decisions on matters entrusted to their business judgment absent a showing of bad faith or gross abuse of that judgment, and this rule extends to bankruptcy proceedings. *See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1046-48 (4th Cir. 1985) (applying business judgment rule to debtor's rejection of executory contract pursuant to 11 U.S.C. § 365). Whether a debtor's decision is so manifestly unreasonable that it could only be based on bad faith, whim, or caprice rather than sound business judgment is a question of fact, and this factual determination is subject to the clearly erroneous standard. *Id.* at 1047.

In its order of February 22, 1988, the bankruptcy court found that L.B.H.'s decision to terminate these arrangements "was not manifestly unreasonable or based on bad faith, whim or caprice. . . . Termination of the Management Contract and Franchise Agreement was in the best interest of the debtor and the estate." Joint App. at 341. The district court affirmed the bankruptcy court's findings. *Id.* at 1094-95 (transcript of district court's oral opinion of June 15, 1989). Because these findings are not clearly erroneous, we affirm the judgment with respect to termination of the Management Contract and Franchise Agreement.

III.

The district court properly affirmed the bankruptcy court's disposition of these matters. For the foregoing reasons, the judgment of the district court is

AFFIRMED.

APPENDIX B

[1]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

IN THE MATTER OF:

L. B. H. ASSOCIATES LIMITED PARTNERSHIP,
Debtor

Civil Action No. PN-89-643
PN-89-811
PN-89-813

QUALITY INNS INTERNATIONAL, INC.
QUALITY HOTELS & RESORTS, INC.
QUALITY INNS, INC.
Appellants

vs.

L. B. H. ASSOCIATES LIMITED PARTNERSHIP,
Debtor/Appellee

Baltimore, Maryland
June 15, 1989

Before: HIS HONOR, PAUL V. NIEMEYER.

[2]

APPEARANCES

For the Appellants Quality:

DAVID F. ALBRIGHT

and

KATHARINE EBERSBERGER

For the Appellants Historic Lord Baltimore Associates Limited Partnership:

ROBERT T. SHAFFER

For the Debtor/Appellee:

DIANA MOTZ

and

IRVING E. WALKER

[3]

PROCEEDINGS

THE CLERK: The matters now pending before the court are Civil Docket Numbers PN-89-811, PN-89-813, and PN-89-643, in the Matter of L. B. H. Associates Limited Partnership versus Quality Inns, and this is a hearing on Bankruptcy appeal.

* * * *

[140]

ORAL OPINION OF THE COURT

THE COURT: All right. I am going to issue an opinion in appeals 89-643, 89-811, and 89-814.

89-813 was voluntarily dismissed and so I will not address that point.

Let me first make an observation about this case, it is a large bankruptcy case, there was a lot of testimony, there was a lot of acrimony, in trying to read, there were a total of 15 appeals in this case, and in trying to read and find out what the positions of the parties were and what the ultimate objections or claims of unfairness were I had enormous difficulty, because I found that it had gotten so acrimonious, and probably even before the bankruptcy, that many claims, objections, were simply to put the other side at an inconvenience and not on the merits.

I found a lot of the objections and disputes arising in circumstances where there may be technical claims to be made, they wouldn't necessarily affect the parties in the particular case. They were simply interposed because there seems to have been a scorched earth policy in the litigation of this case and it started right from the very beginning.

The most telling example of this, which is by no means unique to the parties, was the situation where you have Quality acting as a manager for L. B. H. presumably [141] working together with L. B. H. to try to make a go of the hotel, and at a time when Quality wanted copies of its own business records to be copied on its own xerox machine you have an exchange of correspondence between the parties in which the vice president of Quality says you can't copy the documents. I will let you inspect them during reasonable business hours, and you may then transcribe them. He then begins to quote from the Ninth Collegiate Dictionary the definition of transcribe, which means copy by hand or otherwise transpose by typewriter and, therefore, would not let his own client, so to speak, copy his own client's documents.

I found that to be an extraordinarily trite example of a business relationship, and if that was reflective of what was going on between the parties it is not difficult to understand this case. It is also not difficult to understand the motives of the parties.

I have made an enormous attempt to try to evaluate really what in this case are Quality's troubles with the bankruptcy proceeding, and why it would fight so vigorously, and when you set aside the fact that it was dismissed as the contract manager and the franchisor, there isn't a great deal of disappointment, and there should not be a great deal of disappointment by it in the way in which the estate was set up and the arrangement for payments were made.

[142] It seems to the court that the core of the dispute emanates from the break down of the ongoing business relationship that occurred between Quality and L. B. H. and that is the termination of the Management Contract and the Franchise Agreement, which was coupled to the Management Contract.

What I have done is go through nevertheless all the points raised, and I do want to address them. I will say this, that I am going to affirm all four cases in this, as to relieve any suspense. I have considered carefully every point. There are some which are more difficult legally to handle but, in most instances, I have concluded that they really didn't make any difference and that what took place was ultimately fair for the estate and for the parties.

I am just saddened by the fact that after putting in the effort that the parties have on these appeals that the litigation continues, because there are other cases pending between them. Nevertheless, I will make the rulings on these today and let the parties go wherever proper procedure takes them.

Quality's point one in its 643 brief, which I will address first, is that the creditors were not provided with a full disclosure as required by the bankruptcy code. Quality contends that the order confirming the plan of reorganization should be reversed because the creditors were [143] not provided with the proper disclosure. Quality advances three arguments on this point each of which I am going to consider.

Quality first argues that the disclosure statement, which was distributed to the creditors, failed to contain adequate information. It argues that this issue involved a question of law and the court should, thus, consider the question de novo.

In the court's review of the cases, however, it appears that the question of adequacy of the disclosure statement is a question of fact, and I cite the Kirk versus Texaco case cited in the Southern District of New York. The

finding of the bankruptcy on such a question should be set aside on appeal only if the findings are clearly erroneous.

L. B. H. presents arguments suggesting that Quality lacks standing to make the arguments on behalf of the other creditors and that Quality failed to preserve this issue on appeal. The court notes that this is probably so. It does appear that in many instances Quality lacks standing as it is not, number one, harmed by it, it knew the facts; and, number two, it was not induced to vote against or for the plan because it had already voted against the plan from the beginning. But, more importantly for my discussion here, I believe that the findings of the bankruptcy court were not clearly erroneous.

[144] The requirement that debtors filing a plan for reorganization provide creditors with a disclosure statement is found in Section 1125(b), which provides, I am now quoting:

> "An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest unless at the time of or before such solicitation there is transmitted to such holder of the plan or summary of the plan, and a written disclosure statement approved after notice and hearing by the court containing adequate information."

Adequate information is then defined in 1125 as:

> "Information of the kind and in sufficient detail as far as is reasonably practicable in light of the nature and history of the debtor, and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan but, adequate information need not include such information about any other possible or proposed plan.

Quality argues that the disclosure statement did [145] not contain adequate information because it did not reveal that Saul Perlmutter, L. B. H.'s managing general partner, had mismanaged the hotel by preventing Quality from promoting the hotel, by contributing to cost overruns, and by causing delays in the hotel's opening; also, Quality contends that L. B. H. did not reveal that Perlmutter failed to fund the working capital and debt service account as required by the management agreement with Quality. And, finally, that instead of funding a letter of credit reserve account with $2,000,000 as required by the partnership agreement, Perlmutter put up only $780,000 in the reserve account, and gave the bank a deed of trust on his own home. Quality also argues that the disclosure is inadequate because the projections contained in the agreement were inadequate.

A determination of what constitutes "adequate information" is made on a case by case basis under the facts and circumstances presented in each case. And that is the principle set forth in the Scioto Valley Mortgage Co. case in the Southern District of Ohio, and our own, excuse me, the Kirk versus Texaco case that I referred to in New York provided that the legislative history could hardly be more clear in granting broad discretion to bankruptcy on these types of decisions.

In this case the Bankruptcy court determined that [146] in light of the facts of this particular proceeding, the disclosure statement contained adequate information, and that the debtor did not need to include in the statement all of the negative views about its operation held by its creditors. Particularly, when the debtor did not share those views. The court believes that the bankruptcy court's findings on this issue were amply supported by the evidence and therefore will not disturb them.

As a separate argument with respect to disclosure Quality argues that striking of Quality's competing plan and disclosing statement were error. Section 1121(B)

gives the debtor the exclusive right to file a plan for reorganization for the first 120 days after the order for relief. Section 1121(d) allows the bankruptcy court to extend this period for cause if the debtor so qualifies within the 120 day period.

L. B. H.'s original and exclusive period to file a plan was to expire on January 25, 1988. On that date L. B. H. filed its motion to extend exclusive period of time for filing and obtaining acceptances of plan for reorganization. The bankruptcy court had not yet scheduled a hearing or ruled on this motion when on January 20, 1988, Quality filed a plan of reorganization and a disclosure statement. On June 28th, L. B. H. filed its second motion to extend exclusive period for filing and obtaining [147] acceptances of plan of reorganization, and its motion to strike proposed disclosure statement and plan of reorganization filed by Quality. After consideration of these matters the bankruptcy court granted the relief sought by L. B. H.

The decision of the bankruptcy court to extend L. B. H.'s exclusive period and to strike Quality's plan and disclosure statement was a subject of a separate appeal, 88-2253, which was dismissed without reaching the merits.

Quality now attempts to suggest that by the absence of a competitive plan the ultimate plan was tainted and the confirmation decision should be reversed.

It argues that the absence of the plan left the creditors without full disclosure. However, Section 1125(a) specifically states that a disclosure statement's adequate information need not include information about competeting organization plans. This is also supported by the cases, including the Kirk versus Texaco case. Thus the absence of Quality's plan did not taint the confirmation order by depriving the creditors of the required disclosure.

Quality also argues that the confirmation was tainted because the creditors were improperly denied the oppor-

tunity to consider Quality's competing plan, because the bankruptcy court improperly extended L. B. H.'s exclusive period. If the bankruptcy court's decision to [148] extend L. B. H.'s exclusive period was proper then the decision to strike Quality's competing plan which was necessary to give effect to the extension of the exclusive period was also proper.

Quality argues both that the bankruptcy court could not as a matter of law grant a nunc pro tunc extension of the exclusive period, and even if it could do so, as a matter of law, such an order was abusive discretion in this case.

As mentioned above, Section 1121(b) establishes a period of 120 days after the order for relief during which a plan for reorganization may only be filed by the debtor. Section 1121(d) states "on request of a party in interest made within the respective periods specified—and I want to repeat that to emphasis that—made within the respective periods specified in subsection (b) and (c) of this section and after a notice and a hearing, the court may for cause reduce or increase the 120 day period or the 180 period referred to in this section. Even though L. B. H. first requested an extension of the exclusive period within the 120 day period as required by Section 1121(b), Quality argues that because the request was not granted within the 120 day period the exclusive period ended at the end of the 120 days. The court does not agree with that interpretation of the statute. While the request must be made within the [149] 120 days the decision may be made thereafter, and if Congress intended otherwise it well could have so specified, particularly, in 1984 Congress amended Section 1121(d) to require that a request for an extension of exclusive period be made "within the respective period specified" in Section 1121(c). In 1986 Section 1121(d) was again amended and this time to add reference to 1121(b). On either of these occasions Congress could have added the requirement that the order granting the extension be obtained within the period. But,

it did not do so and left the language to be only that the request would have to be made within the period.

Quality next argues that even if the bankruptcy court, as a matter of law, could extend a debtor's exclusive period, it was improper for the court to do so in this case. The decision whether to grant a motion to extend the exclusive period is a matter of discretion decided on a case by case basis. And, see, In re Public Service Company of New Hampshire decided by the District of New Hampshire in 1988. In this case the bankruptcy court found that following receipt of evidence that L. B. H. had demonstrated cause for granting an extension of the exclusive period. Primarily, based on L. B. H.'s preoccupation with defending against the many challenges by Quality that had begun since the filing of the petition. This finding is adequately supported by the record and is not clearly erroneous, nor [150] was it an abuse of discretion.

Finally, Quality argues that a new disclosure statement after the third modification of the plan had to be filed and circulated. On October 21, 1988, L. B. H. filed its third amended plan of reorganization. This plan differed from the second amended plan in three ways:

First: The third amended plan gave the city of Baltimore an additional interest, excuse me, gave the city additional interest the payment of which was deferred until the year 2001, and subordinated to the payment of the unsecured creditors under the plan except for Perlmutter and his family;

Second: The third amended plan added a provision to the plan to provide for payment of Sovran's allowed secured claim from a letter of credit reserve account which had been pledged to Sovran;

Finally, the third amended plan modified the terms for payment of the F.D.I.C. claims.

Section 1127 allows the proponent of a plan to modify the plan at any time before confirmation, and Section 1127(c) requires a proponent of the modification to com-

ply with the disclosure requirements of section 1125 with respect to the plan as modified. However, Bankruptcy Rule 3019 provides that a modification may be made to an accepted plan without submission to creditors if their interests are [151] not affected by the modification.

It reads, and I am now quoting:

> "After a plan has been accepted and before its confirmation, the proponent may file a modification of a plan. If the court finds after hearing on notice to the trustee, any committee appointed under the code and any other person designated by the court that the proposed modification does not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification, it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan."

Quality argues that it was improper for the bankruptcy court to decide that debtor did not need to file a new disclosure statement after modifications were made to the second amended plan. Quality Inns, however, has no standing to make this argument because it did not accept the third amended plan. The only parties with standing to argue that the modifications required a new disclosure statement are those parties who are were induced to vote for the third amended plan and who were injured by the nondisclosure. See, In re: Middle Plantation of Williamsburg, decided by [152] the Eastern District of Virginia and affirmed by the Fourth Circuit. The statement there made is: "Holders of impaired claims who have been induced to vote in favor of a plan are the only ones who may raise the issue of the adequacy of the disclosure statements." And you should also refer to the In re: Evans Products case decided in the Southern District of Florida.

Assuming that Quality has standing to make this argument, however, the court finds the argument to be without

merit. After hearing evidence on the question, the bankruptcy court decided that further disclosure was not necessary because creditors were not adversely affected by the modifications to the plan. This determination is amply supported by the record and is not clearly erroneous.

As its second point in the 643 appeal Quality contends that the bankruptcy court was required to hold a separate hearing on whether material modifications were made to the plan. It argues that the court erred in not holding a separate hearing to determine the effects of the modification. Quality, however, presents no authority supporting the proposition, and the authority exists approving of the practice of holding the hearings together. See, for instance, the Sweetwater case decided by the District of Utah in 1985, and In re: American Solar King Corp., decided by the Western District of Texas in 1980. [153] Therefore, this court holds that it was not improper for the bankruptcy court to fail to hold a separate hearing on the materiality of the modifications.

As its third point Quality argues that the bankruptcy court erred by confirming a plan which allowed the secured claim with the F.D.I.C.

The third amended plan contained a modification to the terms of payment of the F.D.I.C. claim. Under the modified agreement L. B. H. received concessions on interest payments in the first two years of the plan, including a waiver of over a million dollars in interest for the year 1990. Actually, I think that million dollars is probably for the entire savings, is that what the contention was, Mr. Walker?

MR. WALKER: That would be reflected if you took the four and half percent interest rate that would apply to 1990 and compare it to what the market rate would be plus 1 and three quarter percents, then it would total in excess of a million.

THE COURT: Payment of the principal and interest was deferred until 1990. Prior to the confirmation of the plan Quality had objected to the F.D.I.C.'s plan.

Quality now argues that the bankruptcy court erred by confirming the plan containing this modification. The court would note that this same argument is also presented in the Appeal [154] Number 89-814.

Quality argues that the bankruptcy court should have equitably subordinated the F.D.I.C. claim on the ground that F.D.I.C. engaged in inequitable conduct. The record, however, stands in sharp contrast to Quality's argument. The bankruptcy court found unequivocably, and this court agrees, and I am now quoting from the transcript "F.D.I.C. has operated absolutely magnificently, in good faith, with clean hands, in negotiations which were conducted at arms length with the debtor. It has opted not to exercise its rights in many cases, and has agreed to take less drastic measures in regards to the enforcement of its rights in advantageous position. And I can't think of a situation in which equitable subordination could be any less applicable than this one." That was from the transcript on January 24, 1989, and were the words of the bankruptcy court.

Quality's essential complaint with F.D.I.C. and the court below did not exercise all of its rights when it could have and that the bankruptcy court should not have allowed F.D.I.C.'s exercise of such restraint. Quality submits no authority supporting its view that a creditor can be forced to draw under a letter of credit, or foreclose on a debt secured by collateral. The court is aware of no such authority and will not penalize F.D.I.C. in exercising restraint and giving L. B. H. that chance to get back on its [155] feet.

In addition, the court finds nothing inequitable about F.D.I.C.'s grant to receive 50 percent of litigation money recovered by L. B. H. This agreement does not require L. B. H. to pursue any litigation at all, and it does not obligate L. B. H. to pay any more money than it already owes F.D.I.C. If F.D.I.C. truly had wanted to receive a "windfall," which is how Quality characterizes the litigation agreement, then F.D.I.C. certainly could have acted

well within its rights and been much less accommodating to L. B. H. The court concludes that the lower court's findings were clearly not erroneous, and the court did not err in refusal to apply the doctrine of equitable subordination to the claim of F.D.I.C.

Quality does argue with some force that the court erred below in allowing the F.D.I.C. claim without requiring evidence of the actual debt owed to the F.D.I.C. In F.D.I.C.'s proof of claim filed in September 1987, the F.D.I.C. set forth its debt as $16,690,287.10. In November 1988, approximately, 14 months later, in the agreement for plan of reorganization between L. B. H. and F.D.I.C., which was part of the third amended plan for reorganization, F.D.I.C. set forth the debt at that point as being $18,772,314.00, and some change.

The bankruptcy court heard evidence on the claim at [156] a full-blown hearing on the merits. And Quality submitted no evidence to controvert the amount. The court specifically found the claim to be supported by the evidence presented to it. Quality presents nothing to this court showing this finding to be clearly erroneous.

In fact, in Quality's appeal to the third amended plan, Appeal No. 89-643, Quality does not really rebut in substance the following characterization of the F.D.I.C. claim that was made by L. B. H., and I am now quoting from L. B. H.'s brief in 643:

> "Quality Inns in a passing comment . . . suggests to this court that the plan increased F.D.I.C.'s claim by two million dollars. That suggestion is inaccurate and misleading. As Quality knows the $16,000,000.00 amount to which it refers is the amount of the proof of claim filed by F.D.I.C. at the outset of L. B. H.'s case, to reflect the balance due as of September 1987. The $18,000,000.00 amount reflects the amount due, including accrued interest, as of November 1988. F.D.I.C. as a fully secured creditor, is entitled to be paid accrued interest just as Quality Inns wants to be paid interest on its secured claim."

Moreover, Quality concedes in its brief in 643 that Section 1123(b)(3)(A), permits plans to provide for the [157] settlement or adjustment of any claim. The court does not understand where the bankruptcy court erred in view of the evidence received, the absence of countervailing evidence, and Section 1123 (b)(3)(A) allowing for the adjustment of claims. Accordingly, it will reject the argument and similarly make a ruling on Appeal Number 89-814.

Quality's fourth point in the 643 appeal is that the bankruptcy court erred in failing to hear testimony concerning Saul Perlmutter's history as managing general partner of the debtor. Section 1129 (a) (11), requires a bankruptcy court to examine the likelihood of success of the reorganizational plan it is being asked to confirm. It provides: "The court shall confirm a plan only if all of the following requirements are met." And then dropping down to Subsection 11: "Confirmation of the plan is not likely to be followed by the liquidation or the need for further financial reorganization of the debtor or any successor to the debtor under the plan, unless such reorganization is proposed in the plan."

Section 5.3 of the third amended plan of reorganization entrenches Saul Perlmutter in the management of the debtor. Thus Saul Perlmutter's qualifications as manager were relevant to the question of the confirmability of the third amended plan. I refer to Gulph Woods Corp. case decided by the Eastern District of Pennsylvania, and [158] the Thurmon case decided by the Middle District of Florida, both in 1988.

Quality argues that the bankruptcy court erred by consistently refusing to hear testimony on the subject of the self dealing which Quality argues characterized Perlmutter's management of the debtor. Specifically, Quality argues that it was error for the court to exclude evidence of: One, Perlmutter's failure to fund fully the letter of credit reserve account with $2,000,000.00; and, two, Perlmutter's agreement with the F.D.I.C. to protect

the Perlmutter's home, which was additional collateral for the Sovran letter of credit.

The bankruptcy court realized that Perlmutter's qualifications to manage was relevant to the issue of confirmability of the plan. At the confirmation hearing the court stated, and I am now going to quote the bankruptcy court again:

> "I think the question is whether this plan that is before me will work out. To some extent the question will certainly revolve around whether the management that is in there is going to be successful, but I don't want this to degenerate into the kind of situation where we place one individual on trial and then he has got to come back and say he is a good person. That isn't the [159] issue . . . it seems to me that I am going to have to hear the testimony when the evidence is presented in order to make any kind of decision as to what is or is not relevant. I exhort the parties to use common sense and to try to keep this hearing which is about to begin on a high plane."

Thus, the court did not, and the record reveals the court did not exclude all testimony, but rather was seeking to sort out personal attacks from relevant considerations. The bankruptcy court determined that the specific testimony Quality wanted to present on these points crossed that line and was not relevant to the debtor's ability to successfully manage the hotel. This court agrees with the bankruptcy court, the court agrees with the bankruptcy court's rulings with respect to these two exclusions of evidence complained about above. If Quality believes that other testimony was wrongfully excluded it should have brought the specific rulings to the attention of this court for further consideration. It has not complained about any other rulings except in the most abstract of terms.

The fifth and final point that Quality argues in its brief is that the plan does not comply with the confirmation

requirements of the bankruptcy code. Under this fifth point it makes three arguments:

First, it contends that the third amended plan of [160] reorganization does not satisfy the best interest of the creditors. Before a plan of reorganization may be confirmed the bankruptcy court must determine that each holder of a claim against the debtor has either accepted the plan or will receive or retain under the plan on account of such claim or interest property value—excuse me, or will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 11 [*sic*] of this title on such date. Section, 1129 (a)(7)(A). All parties agree that in the event of a liquidation Quality's secured claim would be paid in full. Therefore, in order to comply with Section 1129 (a)(7)(A), the plan must provide Quality not just with the amount it would receive under liquidation, but also with interest to compensate Quality for the time it must wait to be paid this amount, that is, to compensate Quality for loaning the money to L. B. H. until its claim is paid. The interest paid to Quality should be the market rate of interest for loans of similar duration with similar security and with similar risks. I refer you to the Federal Land Bank of Louisville versus Gene Dunavant and Son Dairy, which was decided in the Middle District of Tennessee in 1987.

The third amended plan in this case provides for a [161] floating interest rate of 1¾ percent above prime on the amount owed to Quality. The bankruptcy court heard testimony from two experts on the interest rate issue, Dr. Edmister, who testified for L. B. H. and Miss Barbara Cohen for Quality. After weighing the conflicting testimony the bankruptcy court accepted Edmister's testimony which supported the plan provision for payment of interest to Quality, and rejected Cohen's testimony who advocated a 15 to 18 percent fixed rate, which was

greater than any current loan which she was administering or which she was aware at the bank at which she worked. The determination of the market interest rate is a question of fact which the court reviews on appeal under the clearly erroneous standard. The bankruptcy court's finding on this question was simply supported by the evidence, which this court will not fully repeat. Suffice it to say the finding is not clearly erroneous.

The second argument made under this point by Quality is that the plan does not comply with the absolute priority rule. The debtor's third amended plan of reorganization permits Saul Perlmutter and D. F. B. Development Corporation, the general partners, to retain their general partnership interest in the debtor by:

> "Receiving five partnership units in exchange for, at their option, (i) reduction of [162] their class 7 claims by $265,500.00, (ii) a cash contribution of $262,500.00 to be made on or before the effective date, or (iii) any combination of cash or reduction of a class 7 claims."

I would note that the class 7 claims are secured claims by definition. These general partnership interests are junior to the Quality unsecured claims which, under the plan, are not being paid in full. Quality, therefore, argues that the plan is not fair and equitable under Section 1129 (b) (2) (B), and that confirmation of the plan was improper.

Quality, however, fails to take into account that in order to retain these interests the general partners must pay cash or give up the equivalent in secured claims. Thus, they are required to put in new money or money value into the estate for the benefit of other creditors.

The court finds that this is not analogous to the "Sweat Equity" that is referred to by the Supreme Court in Northwest Bank versus Ahlers, which was decided in 1988, and will therefore reject this argument.

Finally, Quality argues that the plan should not have been confirmed because it is likely that further reor-

ganization will be necessary. Their argument is built around the belief that the projections provided by L. B. H.'s experts are inaccurate. As the court has already [163] discussed earlier, this is a question of resolving the battle of the experts, which Judge Schneider witnessed and resolved against Quality. The court cannot say, at this time, based on the record that he was clearly erroneous and will, therefore, reject the argument.

With respect to the appeal number 89-811, the appellant, Quality Hotels and Quality Inns, appeal from an order of the bankruptcy court granting the termination of appellee L. B. H.'s limited partnership management contract where Quality Hotels and its franchise contract with Quality Inns. Appellants also appeal from the denial of their motion for reconsideration of that order. The appellants argue that the contract termination should not have been approved by the bankruptcy court because of three grounds: number one, L. B. H. failed to comply with certain conditions precedent; number two, L. B. H. failed to give 30 days notice of termination; number three, L. B. H. failed to act with sound business judgment.

The court notes initially that appellants argue many issues of fact to the court in this particular brief. However, the court does not sit as a fact finder, as was pointed out during the oral argument. Rather, we sit as an appellate court which must leave the bankruptcy court's findings of fact undisturbed unless they are clearly erroneous.

[164] Turning to the first point, the agreement between the parties provides essentially that after L. B. H. had funded initial working capital of $768,000.00, and that sum was exhausted, and after L. B. H. had funded deficits in working capital and/or paid debt service in the amount of 1.9 million dollars out of capital accounts, then L. B. H. could terminate Quality Hotels as its managing agent. The bankruptcy court found as a fact that

L. B. H. had funded $768,000.00 for initial working capital and had funded deficits in working capital or paid debt service in the amount of $3,802,359.00 prior to its termination of the contracts. The court concludes that these findings are amply supported by the record and are not clearly erroneous.

In so ruling, the court rejects appellants argument that L. B. H.'s obligation was to fund specific bank accounts. The issue is not how much money L. B. H. placed in specific bank accounts, but rather it is how much money it provided to the hotel for working capital or debt service. The court finds no error in the bankruptcy court's conclusion that the capital money provided by L. B. H. properly could and did come from more than one source or bank account.

There is no dispute that of the 3.8 million dollars shown on plaintiff's Exhibit 13 went into the operations of the hotel and its debt service. To suggest that the money [165] had to come from account 841 was unsupported by the agreement, the management agreement, that is, and moreover succumbs to form without regard to any substance of the agreement.

Appellants also argue that L. B. H. defaulted prior to its termination of the contract by not funding the working capital account in accordance with the management contract schedule. The court agrees with the appellee that compliance with this schedule was not a condition precedent to L. B. H.'s right to terminate the contract. As a matter of fact, a reading of the condition precedent provides that the 1.9 million dollars could be paid at any time after the $768,000.00 has been exhausted.

Quality never told L. B. H. that it regarded L. B. H.'s noncompliance with the schedule as a default and it allowed these defaults, if they were defaults, to pass without any protest. Accordingly, the court will reject that ground, that argument, as a ground for reversal.

The second point that Quality makes is that the, with respect to the second point the court does not find any

error in the bankruptcy court's conclusion that the management and franchise contracts came to a proper end in October after expiration of the 30 day notice period. The contract provided that after L. B. H. provided notice of termination Quality could avoid termination by contributing [166] within 30 days cash equal to the amount of capital contributed by L. B. H. during the preceding two years, a figure of, approximately, 4.5 million dollars. Quality argues that notice was defective and that it was unable to exercise its option to avoid termination, by contributing capital, because L. B. H. obtained an injunction against Quality's interference with new management. However, the injunction did not prevent Quality from tendering the necessary capital, and in fact Quality never even attempted to tender any capital during the thirty days following the notice of termination. Accordingly, the court finds no error in the bankruptcy court's conclusion that notice of termination was properly given under the contract and that no curative action was taken by appellants to avoid the termination.

It would also be noted as a side point during the period of 30 days Quality did receive the fees, franchise fees and the management fees, to which it was entitled.

Moreover, because the contract provided that the valid grounds for termination of the management contract also provided valid grounds for termination of the franchise contract, the court finds no error in the termination of the franchise agreement for the same reasons it finds no error in the termination of the management agreement.

Finally, with respect to the third point, the [167] question of whether or not L. B. H. exercised sound business judgment is perhaps the most fact-bound question on this appeal. The judge's finding that L. B. H. exercised sound business judgment was not clearly erroneous. There was ample material in the record for the judge to conclude that L. B. H. was in a bad situation that was becoming worse, with low occupancy rates, enormous financial losses, and little or no cooperation from Quality, and that

the termination of its contracts with Quality was a business judgment.

For the reasons that I have outlined herein in this oral opinion today, and because of the larger picture that I have described early on, the court believes that the plan was carefully considered, evaluated, and approved, in the best interest of revitalizing the hotel, the plan, as confirmed, should not be disturbed. The court believes that much of the controversy was motivated by the desire of one or two parties to cause difficulty to others because of the hostility that developed between the parties in their business relationship. When issues are so motivated, when the issues so show motivated are set aside the correctness of the procedures becomes yet more apparent.

The court will therefore enter a separate order affirming the bankruptcy court's decisions in these three appeals and rejecting these three appeals. The fourth [168] appeal, that is, case number 89-813 has been voluntarily dismissed by the appellants and is rendered moot at this point in time.

Are there any questions or further clarifications needed?

(No response.)

THE COURT: That will resolve it and we will stand recessed.

(Hearing concluded.)

* * * *

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil Nos. PN-89-643, PN-89-811 and PN-89-814
QUALITY INNS INTERNATIONAL, INC., *et al.*

v.

L.B.H. ASSOCIATES LIMITED PARTNERSHIP

ORDER

For the reasons given in the oral opinion delivered in Court on June 15, 1989, it is hereby ORDERED this 21st day of June, 1989, that:

1. The appeals in these cases are rejected and the orders of the Bankruptcy Court are affirmed; and

2. The Clerk is directed to mail a copy of this Order to all counsel of record in each of the cases.

/s/ Paul V. Niemeyer
PAUL V. NIEMEYER
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Case Number 87-5-2207-JFS (Chapter 11)

IN RE: L.B.H. ASSOCIATES LIMITED PARTNERSHIP
Debtor

U.S. Bankruptcy Court
101 West Lombard Street
Courtroom 9C
Baltimore, Maryland

Monday, December 5, 1988—9:40 a.m.

Before: THE HONORABLE JAMES F. SCHNEIDER

* * * *

[216] THE COURT: I heard some mention earlier of a request to have written submissions. My inclination is to announce my decision from the bench now and then if there are requests that any of the parties would like to make either in the way of modifications of the decision or motions for reconsideration, I would entertain those. I would [217] also entertain from whoever wishes to submit the order of confirmation, variations on what that order ought to contain. And I will certainly entertain those.

I guess in a sense that announces the decision without my coming right out and saying it. But I always prefer to announce the decision at the beginning because, even though it takes away the dramatic tension, from the

statement itself, it avoids having people sitting on the edge of their seat worrying about what the decision is going to be. The decision in this case is going to be that the plan will be confirmed.

Now, I have already indicated that I will hear from counsel if they have a request before I announce the bases of the decision and the elements, the various elements of it. Mr. Albright?

MR. ALBRIGHT: How much time would you like—you mean orally?

THE COURT: No, you indicated that you wanted to—

MR. ALBRIGHT: Yes.

THE COURT: Submit written—

MR. ALBRIGHT: Yes.

THE COURT: Some written submission. And [218] I have indicated that I would prefer to have that done after the decision is announced and after an order of confirmation has been entered.

And then in connection with that order of confirmation, I am also willing to entertain any written suggestions as to what that order of confirmation ought to contain, and I will hear from anyone who wishes to be heard about that.

MR. WALKER: Your Honor, if I may. The debtor's problem is that, as it has been at the outset, is time. And if it were just a matter of counsel submitting proposed submissions tomorrow, I don't have any problem with that. But if we're talking about something that will delay the order being entered in the court, that would have a very serious effect on the debtor. And I respectfully ask that the opportunity be—we have all been in this case for weeks and weeks, and we should know what we want the court to propose if they want to put it in writing, and I don't think that should require any additional time.

THE COURT: Well, I don't think that it is too much to ask that the order not be entered before Friday of this week, today being Monday. And the parties can circulate

between each other what their [219] submissions will be, and I will enter an order on Friday, come what may.

And then obviously the rules will govern the course that the parties will take thereafter, and I don't need to tell them what that is, but nevertheless that is what I would propose to do. Without further adieu, I will certainly go into an oral statement of the decision in this case. And I will attempt to simply hit the high spots and not go into any great depth.

This case in many respects has been a battle of personalities and certainly personalities have dominated the confirmation hearing, principally the personalities of the attorneys.

I am willing to say at the outset that I think all of the attorneys represented their clients ably and to a very high degree of—a very high performance I should say. I have never seen the cross examination of witnesses conducted with such skill as I have seen Mr. McDaniel employ. And I felt that in just about every circumstance where he conducted the cross examination of a witness that I was in the presence of a master on that. So that even though I might not have agreed with his position in the case, I thought he was a very able [220] counselor.

And certainly no one would quibble with the tenacious manner of Mr. Albright who certainly has represented the Quality enterprises from the beginning with this same degree of zeal.

The counsel for the Perlmutter family, whether it was Ms. Flax or Ms. DeVan, certainly ably represented their clients.

And finally, last but not least, I have to comment on both Irving Walker and Harvey Lebowitz who I think did an outstanding job also from day one on behalf of LBH. There is nothing in any particular area that I could congratulate them on. I thought the overall performance was excellent, and I think the preparation of the plan and disclosure statement was exemplary.

My job in this case is not to predict the success of the hotel, certainly not to guarantee the success of the hotel, nor to say whether or not from an actual viewpoint as a prognosticator whether the hotel as an enterprise will be successful.

My job is strictly to look at the plan and to determine whether the plan is legally confirmable based on the best estimates with respect to how the hotel will do.

[221] So that the confirmation of this plan does not in any way guarantee the success or the failure of the hotel. And the hotel will be on its own in that regard. I think everyone knows that, although sometimes we tend to lose sight of it.

I am going to entertain an order of confirmation in this case. I have confidence that the hotel will succeed because otherwise I would not entertain an order of confirmation, but at the same time there are imponderables and unforeseen events which may occur which may affect the performance of the hotel. My understanding of this case from the beginning, my familiarity with all of its elements, and all of the people involved in the case from day one leads me to the conclusion that the hotel will be a success, that the plan will work, that the components of the plan will ultimately come together and make it work.

I have several reasons for this belief based on my knowledge of the case. The first one is I am satisfied that the people who are running the hotel are familiar with the operation of the hotel and the Brookshire management certainly I think gives promise that the hotel will succeed as a commercial enterprise.

[222] That is not to say that their predictions in the past may have missed the mark, but nevertheless it seems to me that the performance of the hotel to this point has been more than satisfactory. I base that statement on the evidence which I have heard from—primarily from the witnesses for the debtor certainly, but even to some degree upon the testimony of Mr. Bennett.

Mr. Bennett was praiseworthy of the hotel in many respects, and it seems to me that there were some things that he said that were even favorable to the hotel, certainly to its physical appearance and layout, but nevertheless beyond that it seems to me that the management of the hotel is the all-important factor at this point. And I am satisfied that the people who are running the hotel know what they are doing.

And second, perhaps most importantly, I am satisfied that Saul Perlmutter and the Perlmutter family have with a single-mindedness guided this hotel through some very rough terrain.

Mr. Perlmutter brought the hotel into the bankruptcy court. He took that precipitous step I think with a view to change the direction that the hotel was taking under the Quality management. [223] Unsatisfied with the management, unable to deal with the management, for whatever purpose, Mr. Perlmutter was willing to gamble to bring the hotel into the bankruptcy court with a view to reject that executory agreement with the Quality people.

Whether you agree with Mr. Perlmutter or not, I think you have to admire what he has done with the hotel. I think you have to admire what he has done with the managemenet of the hotel since it has been in bankruptcy. And I am satisfied that Mr. Perlmutter will continue to do what in his own mind he believes to be in the best interests of the hotel. And up to this point, I think what he has done has been in the best interests of the hotel. And I endorse what he has done.

Again, I am not making any conclusions as to who is at fault with the relationship between Mr. Perlmutter and the Quality people. But certainly it doesn't take an expert to know that they—the two sides have reached an impossible position where they couldn't agree on anything. They weren't talking. And a continuation of that relationship would have resulted in a loss to the hotel and to the business. And certainly there had to be some resolution of that.

[224] So I salute Mr. Perlmutter and the Perlmutter family. I think a lot of the good things that have happened in this case have been at their instance and they ought to be recognized for that. I don't think that the plan is necessarily overly favorable to them. And I think in many respects this case has cost them a great deal. And I want to recognize that.

Another reason to confirm the plan is the name that is now on the hotel, that of Radisson Plaza. What fears exist regarding the future are partly assuaged by the fact that there is now a recognized national chain which has a reservation service in place, that have every expectation of bringing a sizable number of guests to the hotel in the future. And certainly that bodes very well for the future of this case.

I disagree with Mr. Albright in his recollection of what happened in this case with the obtaining of a national franchise. My recollection is that efforts were underway almost immediately as soon as the Quality people were out of the picture to obtain a nationally recognized franchise that would benefit the hotel.

And my recollection further is that it [225] took some months before the negotiations resulted in a favorable agreement with the Radisson people. My recollection is that every effort was made by the Brookshire people to obtain a national franchise and that there was not the kind of foot-dragging that was mentioned today. Certainly if there was, it wouldn't have been logical because such foot-dragging—dragging did not benefit the hotel.

I was personally fearful of—for what the future held for the hotel when earlier this year I was given the results of the preceding months where the occupancy rate had fallen so disastrously. But I was willing to give the hotel the benefit of the doubt with respect to getting a new franchise. And it seems to me that the Radisson franchise is going to pay off in dividends to the debtor and to its creditors in this case. This is a very favorable franchise. And I am satisfied that it is really one of

the pivotal factors in leading to confirmation of the plan.

I am delighted to see the FDIC agreement in this case. Only a—a party—the only party who I think that objected to this FDIC agreement would be a party whose —who cannot see the—the objectivity of this situation because of its own [226] interests. And by that I mean the Quality people. The problem with Quality is certainly Quality has the right to object, and it has objected at every turn in this case to everything that the debtor has attempted to do.

The problem is that, because of that, one has to look objectively at the Quality objections. And it doesn't take long to see that Quality does not want to see this plan confirmed under any circumstances because of its own perception of its own self interest in this case.

But looking at the FDIC agreement objectively must lead one to the conclusion that it is in absolutely the best interests of the debtor. And why the FDIC gave up some of the things they gave up, I have no way of knowing, but I am happy to see on behalf of the debtor that it did, because certainly this will bode well for the debtor, and perhaps in the long run it will bode well for FDIC because it will lead to its being paid off. So I congratulate counsel for FDIC on the agreement. And on behalf of the debtor and creditors in this case, I thank the FDIC publicly on the record.

Last but not least for this list of reasons to confirm, which really come down to names [227] of individuals and entities, certainly the Mayor and City Council of Baltimore ought to be thanked for what they have done.

I note the provisions of the plan state with respect to the City of Baltimore, I know what the City of Baltimore has done by reason of seeing the papers which were filed in this case, the refinements that were achieved by counsel for the debtor—with—working in concert with counsel for the City of Baltimore. And they give promise of leading to a successful conclusion as well.

And finally, not only the Mayor and City Council of Baltimore, but it seems it to me the citizens of Baltimore ought to be brought into this equation, because it seems to me that Baltimorians know a good product when they see it. And the Lord Baltimore as it has been redefined and brought into this century by the incredible improvements that have been brought there both physical and otherwise, I think will flock to the hotel and insure its financial future thereby.

Now, one thing I have discounted in coming to this conclusion is some of the negative testimony that was elicited by the limited partners. If I were to have believed everything that some of the [228] negative witnesses testified about, this hotel should have been turned into a warehouse or a hospital or an office building, because essentially, and I am not going to pin down which ones said this, but the implication became clear that unless a hotel in Baltimore is built on the very shores of the harbor it will not succeed. And I don't believe that for one minute.

There are too many hotels in Baltimore to believe that only those few which are on the water's edge will be successful. And if I could think of this as a bankruptcy judge, certainly there must be some hotel expert out there who can figure out that it doesn't take much to get a shuttle bus between the harbor and the hotel as opposed to moving the hotel to the harbor. It seems to me that if the key to success is to bring the interest of the harbor to guests at the hotel, then that is one way to do it, but certainly there are a myriad of solutions that are possible to enliven the atmosphere of the hotel and to capitalize on the Inner Harbor. And so it seems to me that that is not an insurmountable obstacle to success in this case.

I accept Mr. Rushmore's appraisal of the property. As far as I am concerned, it was the only [229] competent appraisal in evidence that was worthy of unequivocal belief because it was uncolored by any inter-

ests, absolutely not colored by any interest. And it was expert testimony because as far as I am concerned Mr. Rushmore was the only real appraiser who testified.

That is not to downgrade the testimony of any others. I have more confidence in it because it comports with my understanding of what is involved in this hotel. I have lived in Baltimore all my life, and I have seen the Lord Baltimore Hotel. I know where it is, I know what it is near, I know what its competition is downtown, and I know what its competition is in the wide geographical area. And I am satisfied that the Lord Baltimore is a first class hotel. I don't know if it is a four or five-star hotel, but it certainly is a world class hotel. And I certainly think it competes well with the Omni, with hotels that are around the water's edge of the Inner Harbor.

And let me say one other thing, it seems to me that visitors from out of town are not going to care particularly whether the harbor is nearby or not. The harbor is only a few blocks away, and I don't think that even is a real factor. I don't [230] think Rule 3019 makes a hill of beans with respect to confirmation of the plan. It is a red herring through and through. It might take an experienced bankruptcy judge or practitioner to recognize that, but the first thing that leaps out is after hearing on notice, and that means after opportunity for hearing on notice, there has been opportunity to hear everything about this modification. There has been an opportunity to present all the negative evidence that can possibly be brought to bear with respect to whether this modification is significant.

And primarily it seems to me that the question of who is objecting is all important here. The parties who object to the modification are those parties which rejected the plan anyway. And they are in a minority. The modification even with the addition of the new class is insignificant to the result.

I am sorry the case has been so acrimonious. And I wish that, of all the people involved in this case, that

the limited partners could find a way to get on board with this confirmed plan because I really do think that it is in their best interests to attempt to sit down and work out an agreement with the general partner. I think it [231] will be advantageous for the limited partners both from a tax standpoint and from the standpoint of a realization on their investment that they get on board.

I think the worst thing that could happen would be further litigaiton in this case, although I expect that there will be appeals, maybe an appeal, and certainly I have no feeling one way or the other as to what the district court ... uld do with my opinion. I have been reversed before. And I wouldn't like to say I am used to it, but it has happened on occasion.

And certainly a district court or circuit court is free to disagree with me, but my feeling at this point is that this is the decision that is legally correct and will stand up on appeal.

And my worst fear is that the parties will continue to litigate uselessly and waste a lot of their own time and efforts in a cause that will not lead to any successful conclusion.

Whereas if there is the opportunity to sit down and negotiate, I think that has much more promise of success than further litigation. And again, I look to the limited partners because it seems to me that the key to such negotiation is the [232] terms—are the terms of any new partnership agreement.

One of the problems I had with confirming this plan early on was the fear that I would be confirming an open-ended plan that had an amended partnership agreement that had not been nailed down. And I know Mr. McDaniel argued that point today quite ably.

The thing is the plan does provide for what happens to the limited partners and the provision regarding the amended partnership agreement is for the benefit of the limited partners. It gives them room to negotiate with the debtor. It doesn't foreclose them, it doesn't lock them

into a bad deal. They have the right to come in in their own best interests and invest.

And the absolute priority rule deals with how they are treated under the plan. And according to what I know of that, the plan is proper.

I think the time has come for everyone in this case to put personalities aside and to try to think of not only their own interests but the interests of the hotel and the future of the hotel. I have no question in my mind that the plan comports with the requirements of Sections 1126 and 1129.

[233] 1126 is the provision in the bankruptcy code that regulates the voting on the plan. And certainly from the tally furnished me in this case the acceptance of this plan by the creditors has been overwhelming, the number of creditors voting and in the amount of claims they hold, more than is required by the provisions of Section 1126.

With respect to the Section 1129, I am satisfied that Mr. Walker's litany comports with my findings regarding compliance with those provisions, and I will specifically point to the cram down provisions in making the finding that the treatment of the nonaccepting classes is fair and equitable, and also that it does not discriminate unfairly against them.

I am satisfied that the makeup of the classes is legal, has been considered properly and that there has not been an unfair discriminatory classification of anyone in the terms of this plan.

I agree with those cases set forth in the debtor's memorandum which indicate that it is proper to classify unsecured creditors in different classes depending upon the special circumstances that exist so long as that classification is not used for purposes of disenfranchising those creditors or [234] doing some other negative—having some other negative effect upon them strictly for that purpose. And certainly I don't think that could be argued in this case where the acceptance by the voting creditors has been so overwhelming.

I don't know what more I can say other than to congratulate all of you for having survived sitting in this hearing as I did from the very first day that it began, namely October 24th—

MR. ALBRIGHT: Your Honor—

THE COURT: —in '88. And I think the endurance of all of you has been praiseworthy. All of us have invested parts of our lives in this case. I will always remember 1988 as the year of the Lord Baltimore case.

MR. WALKER: Your Honor, may I just make one comment?

MR. ALBRIGHT: Your Honor—

THE COURT: Everyone wants to make some comments, and I am certainly willing to entertain those.

MR. ALBRIGHT: Could I ask the court one—just two points?

THE COURT: I always leave something out when I do this, so I am certainly willing to hear [235] from everybody.

MR. ALBRIGHT: Your Honor, you did not mention one way or the other as to whether you accepted our—our viewpoint on 15 to 18 percent interest rate on Quality's claim.

And also, the second point is that the—you made a comment about the only real appraiser was Rushmore. The only competent appraisal. I don't know that that is fair to the appraiser that we brought here that that is a rather extreme statement. Mr. Walsh is an MAI and Mr. Ayre was with him. I thought the statements were a little bit more extreme than the situation would warrant.

THE COURT: One of the things I didn't like about their work was that they did not prepare a written appraisal. I thought there was something wrong with that. I thought that in a case that was worth so much they should have gone that extra step and had a written appraisal, because that was the reason that we had to have Quality Exhibit Number 11. I believe it was that,

had that great big thick pile of work papers which was really difficult to go through. I did it, I think I understood what was in it. But this you may well have evolved upon trial strategy. I don't understand why it was done, but I [236] don't think it should have been done. I hope I never see that again in another case of this kind, especially a case of this magnitude.

MR. WALKER: Your Honor—

THE COURT: I think it reflects poorly on the people who prepared the report. I think it reflected poorly on Quality for not having—

MR. ALBRIGHT: Your Honor—

THE COURT: Here is Quality, a multi-million dollar corporation. I don't know why the powers that be decided not to do that.

MR. ALBRIGHT: Your Honor, any comment on the interest rate?

THE COURT: I would like to hear from everyone before I make any statements. I have also learned a few things, and one of those few things is that when you sit up here, you don't have to answer the questions. I may end up having to at some future time, but I always prefer the opportunity to think about those questions before I jump in with both feet and make a mistake.

MR. WALKER: Your Honor, I am not sure if I heard best interest test under 1129-A7 that each will receive for the plan than the award of liquidation.

[237] THE COURT: I am absolutely satisfied with that. You may not have heard that because I did say under 1129 the litany that you read into the record earlier I fully agreed with. I did make a statement that the cram down provisions of the code were properly invoked in this case. You are right, I did neglect A7.

MR. McDANIEL: Your Honor, my client is faced with a series of deadlines with situations of what they have to do. There is some potential for ambiguity, one is that the effective date or the trigger date for them to make payments. The effective date is defined in the plan

as the 30th day after the order of confirmation becomes final or such earlier date as may be specified by the debtor. But there is no mechanism in here for how that specification will be made or transmitted to the limited partner or anything like that. And I am concerned that there could be a decision unilaterally made by the debtor to specify an earlier date as the effective date of the plan, which would make it very difficult for my clients to know when to respond.

My second concern is that the confirmation date determined to be final upon the happening of [238] three—any of three events, the first two of which—I understand the third one is if an appeal has been timely filed but the order of confirmation has not been stayed. It seems to me that creates an ambiguity about the period after which the order is entered and the time to seek a stay runs and we may seek one and we may not.

We may have to protect ourselves, I don't know, in that period of time. But if a stay is sought and denied or not sought, it seems it could create some ambiguity as to when the order of confirmation becomes final. And those are obviously very important points for any clients and for me as an attorney to understand thoroughly before we decide what to do and when to do it.

THE COURT: Well, I don't know that this is anything I can aswer.

MR. McDANIEL: I am not sure it is, your Honor.

THE COURT: I think the concern is there, I understood that in the closing argument as well. By the way, the closing arguments of all counsel were excellent. Absolutely excellent. At one point I stopped taking notes because I was paying so much taken attention to what was said that I didn't want [239] to lose track of that by taking the time to write.

It seems to me that this is an opportunity being presented here by Mr. McDaniel possibly to build some bridges. I don't say anything much further on those lines, but I agree with you, there is some gray area with

respect to the effective date which I would expect to have resolved in the order of confirmation. And that gives you then the next few days to attempt to work that out.

I really do think that the limited partners in this case were reasonable people from what I could see. I think they are reasonable business people and they have the opportunity to work with them. I say that without knowing anything about whatever settlement negotiations went on. I don't want to know that. I am not legally permitted to know that.

But Mr. —the Messrs. Doud both testified before me, and I had the opportunity to observe their demeanor, and I was impressed by them.

Actually, I thought the most interesting witness was Mr. Bennett. And I think counsel must have recognized that too because he got away with all kinds of objectionable things but we were all sort of waifed along with him. I learned more [240] things that I never knew about the hotel business and his own personal life. And so anyway, thank you all. It has been quite an ordeal. But as I said earlier, we survived. And let's hope the next few days can be used to the benefit of all of you, working together.

MR. ALBRIGHT: Thank you, your Honor.

MR. McDANIEL: Thank you, your Honor.

MR. WALKER: Thank you, your Honor.

(Thereupon, at 5:10 p.m., the hearing was concluded.)

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND

Case No. 87-5-2207JFS

(Chapter 11)

IN RE: L.B.H. ASSOCIATES LIMITED PARTNERSHIP,
Debtor.

ORDER CONFIRMING THIRD AMENDED PLAN OF REORGANIZATION AND AUTHORIZING DEBTOR TO OBTAIN SECURED CREDIT

[Filed Dec. 9, 1988]

Upon consideration of the Debtor's Third Amended Plan of Reorganization (the "Plan"), filed by L.B.H. Associates Limited Partnership (the "Debtor"), and the Court having read, heard, and considered the objections to confirmation filed by Quality Hotels & Resorts, Inc., Quality Inns International, Inc., and Quality Inns, Inc. (collectively, "Quality") and Historic Lord Baltimore Associates Limited Partnership and Investment Services Incorporated ("Historic/ISI"), and the motions and memoranda of the parties relating to the Plan, and the testimony and other evidence and arguments of counsel presented at the confirmation hearing, which commenced on October 24, 1988 and concluded on December 5, 1988, as well as the entire record of this case; this Court hereby makes the following findings of fact and conclusions of law:

Findings of Fact

1. The Debtor has complied with the applicable provisions of the Bankruptcy Code in taking the necessary steps to reorganize, in proposing the Plan, in preparing the Disclosure Statement, and in soliciting acceptances of the Plan, and in generally fulfilling its duties as debtor in possession.

2. The preparation of the Plan and Disclosure Statement was exemplary, and the Plan has been proposed in good faith and not by any means forbidden by law.

3. Any payments made or to be made by the Debtor for services, costs, and expenses in or in connection with the case have been approved or are subject to the approval of the Court as reasonable.

4. The Plan discloses the identity of the individual, Saul Perlmutter, who will continue to serve as the Debtor's managing general partner, and the nature of any compensation he will receive for his services.

5. The continuance of Mr. Perlmutter, who as the managing general partner has shown a single-mindedness in guiding the Hotel through some very rough terrain, is consistent with the interests of creditors, equity security holders, and public policy. Mr. Perlmutter's prior actions have been in the best interests of the Debtor's Hotel, the Lord Baltimore Radisson Plaza (the "Hotel"), and the Court is satisfied that Mr. Perlmutter will continue to act in the best interests of the Hotel and the Debtor.

6. The Plan has been accepted by ballot by Class 4, Class 6, Class 7, Class 8, Class 9, Class 13, and Class 14, which constitute all of the impaired classes of claims or interests except for Class 5, Class 10, Class 11, Class 12, and Class 15. These latter classes, which are comprised by Quality and Historic/ISI, are also impaired and have voted to reject the Plan. Class 4, Class 6, Class 8, and Class 9 contain no insiders.

7. Class 1, Class 2, Class 3, and Class 16 are unimpaired and are deemed to accept the Plan.

8. Each holder of a claim or interest in an impaired class has accepted the Plan or will receive or retain under the Plan on account of their respective claim or interest not less than such holders would receive if the Debtor were liquidated under Chapter 7 of the Bankruptcy Code. The liquidation of the Debtor in Chapter 7 would at best result in the payment of allowed secured claims, with unsecured creditors and equity security holders receiving nothing after payment of administrative and other priority claims. In particular, Quality Inns, Inc. will receive or retain under the Plan, on account of its allowed secured Class 5 claim, property of a value as of the effective date of the Plan that is not less than the amount that it would receive or retain if the Debtor were liquidated under Chapter 7 of the Bankruptcy Code on such date.

9. The Plan properly provides for payment in full of administrative and priority claims.

10. The management of the Hotel is an all-important factor. The performance of Hospitality Group of Lord Baltimore, Inc., a subsidiary of Brookshire Hotels, Inc., which is managing the Hotel, has been more than satisfactory, notwithstanding the fact that their past forecasts may have missed the mark.

11. Based upon the Court's familiarity with the record of this case from its beginning and all of the parties and individuals involved in the case, the Court is satisfied that the Hotel will be a success. Although no one can guarantee the success of the Hotel, it is now under competent management and is capable of fulfilling, and can be expected to fulfill, its obligations under the Plan.

12. The acquisition by the Debtor of the very favorable Radisson Plaza franchise, which associates the Hotel with a nationally recognized chain and reservations system, is a pivotal factor in finding a likelihood of the Hotel's success.

13. Confirmation of the Plan is therefore not likely to be followed by liquidation or the need for further reorganization of the Debtor.

14. All fees required by 28 U.S.C. § 1930 have been paid or will be paid as an administrative expense on the effective date of the Plan.

15. With respect to Class 5, Quality Inns, Inc. will retain under the Plan its lien to the extent of the allowed amount of its Class 5 claim and will receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value as of the effective date of the Plan, of at least the value of its secured claim. In particular, the Court accepts the testimony of Dr. Robert Edmister that interest of 1¾% over the "Prime Rate" (as defined in the Plan) is the appropriate interest rate to be paid on account of Quality Inns, Inc.'s secured claim, and finds that the Plan provides for the payment of a fair market rate of interest on the Class 5 secured claim.

16. With respect to the nonaccepting impaired creditor classes, Classes 10, 11, and 12, the holder of any claim or interest junior to the claims of such classes will not receive or retain under the Plan any property on account of such junior claim or interest.

17. With respect to Class 15, the holder of any interest that is junior to the interest of such class will not receive or retain under the Plan any property on account of such junior interest.

18. Sharon Savings Bank, F.B.S. ("Sharon"), Federal Deposit Insurance Corporation ("FDIC"), the Mayor and City Council of Baltimore (the "City"), and Saul Perlmutter and DFB Development Corporation, who hold mortgages or liens on the real property, improvements, and personal property of the Hotel, located at 20-30 West Baltimore Street, Baltimore, Maryland 21201 (the "Property"), have accepted the Plan and have consented to the provisions of the Plan relating to the Debtor's obtaining

from Sharon a loan of $2,150,000 (the "Sharon Plan Loan") secured by a lien on the property pursuant to the terms of the Plan.

19. The Debtor is unable to obtain the necessary credit from Sharon or any other lender without securing the loan in the manner and with the priority provided for in the Plan.

20. The Court accepts the appraisal made by Mr. Stephen Rushmore of Hospitality Valuation Services, Inc. and finds that the Property has a fair market value of $30,000,000. Mr. Rushmore's appraisal was the only credible appraisal in evidence. The valuation presented on behalf of Quality by Laventhol & Horwath, which did not include a written report, was not credible.

21. The Hotel's present value exceeds the total sum of the secured claims of Sharon (including the secured claim arising from the $300,000 loan made in February 1988 and the Sharon Plan Loan), the FDIC, and Quality Inns, Inc.

22. The interest in the Property of Quality Inns, Inc. will remain adequately protected after confirmation of the Plan.

23. The Agreement for Plan of Reorganization between the Debtor and FDIC, which is incorporated into the Plan, is clearly in the best interest of the Debtor, creditors, and the estate.

24. The acceptance of the Plan by the City, particularly the latest refinements incorporated in the Plan, is a significant contributing factor to the expected success of the Plan.

25. The modifications made to the Debtor's Amended Plan of Reorganization (filed on August 30, 1988) and incorporated into the Plan) are insignificant to the results under the Plan for any creditor or interest holder who accepted the Debtor's Amended Plan of Reorganization.

26. The Plan provides fair and equitable treatment of all holders of claims and interests, and does not unfairly discriminate against any creditor or interest holder.

Conclusions of Law

27. The Plan complies with the applicable provisions of Title 11 of the United States Code. In particular, the classification of claims and interests under the Plan is proper and comports with 11 U.S.C. § 1122.

28. The Plan complies with all of the provisions of 11 U.S.C. § 1129:

(a) The Debtor complies with the applicable provisions of Title 11 of the United States Code.

(b) The Plan has been proposed in good faith and not by any means forbidden by law.

(c) Any payment made or to be made by the Debtor, or by a person issuing securities or acquiring property under the Plan, for services or for costs and expenses in or in connection with this case, or in connection with the Plan and incident to this case, has been approved by, or is subject to the approval of, this Court as reasonable.

(d) The Debtor has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the Plan, as a director, officer, or voting trustee of the Debtor, to the extent required by 11 U.S.C. § 1129 (a)(5), and the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy. The Debtor also has disclosed the identity of any insider that will be employed or retained by the reorganization Debtor, and the nature of any compensation for such insider.

(e) The Debtor has not sought under the Plan any rate change subject to the jurisdiction of any government regulatory commission.

(f) With respect to each impaired class of claims or interests, (i) each holder of a claim or interest of such class has accepted the Plan or (ii) will receive or retain under the Plan on account of such claim or interest property of a value, as of the effective date of the Plan, that is not less than the amount that such holder would so receive or retain if the Debtor were liquidated under Chapter 7 of the Bankruptcy Code on such date.

(g) With respect to each class of claims or interests, other than Classes 5, 10, 11, 12, and 15, (i) such class has accepted the Plan, or (ii) such class is not impaired under the Plan.

(h) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the Plan provides that: (1) with respect to a claim of a kind specified in § 507(a)(1) or § 507(a)(2) of Title 11, on the effective date of the Plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim; (2) with respect to a class of claims of a kind specified in §§ 507(a)(3), 507(a)(4), 507(a)(5) or 507(a)(6) of Title 11, each holder of a claim of such class will receive (i) if such class has accepted the Plan, deferred cash payments of a value, as of the effective date of the Plan, equal to the allowed amount of such claim, or (ii) if such class has not accepted the Plan, cash on the effective date of the Plan equal to the allowed amount of such claim; and (3) with respect to a claim of a kind specified in § 507(a)(7) of Title 11, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the Plan, equal to the allowed amount of such claim.

(i) At least one class of claims that is impaired under the Plan has accepted the Plan, determined without including any acceptance of the Plan by any insider.

(j) Confirmation of the Plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the Debtor or any successor to the Debtor under the Plan.

(k) All fees payable under section 1930, have been paid or the Plan provides for the payment of all such fees on the effective date of the Plan.

(l) The Plan does not discriminate unfairly, and is fair and equitable, within the meaning of 11 U.S.C. §1129 (b) (1) and (2), with respect to Classes 5, 10, 11, 12, and 15, which are the class of claims or interests that are impaired under, and have not accepted, the Plan.

29. The objections to confirmation of the Plan filed by Quality and Historic/ISI are without merit.

30. The Debtor has complied with the requirements of 11 U.S.C. § 1125 in all respects.

31. The modifications to the Debtor's Amended Plan of Reorganization, which are incorporated in the Plan, comply with 11 U.S.C. § 1127, 11 U.S.C. §§ 1122 and 1123, and Bankruptcy Rule 3019. In particular, the requisite hearing on notice of such modifications was provided and the parties who objected to the modifications, Quality and Historic/ISI, were present and represented by counsel at the confirmation hearing, with which the Court heard and considered arguments on the Plan modifications. In addition, neither Quality nor Historic ISI may object to the modifications under Bankruptcy Rule 3019, because neither of them accepted the Debtor's Amended Plan of Reorganization.

32. The modifications made to the Debtor's Amended Plan of Reorganization do not materially and adversely impact any party who previously voted for the Plan.

33. Accordingly, the Plan shall be deemed accepted by all creditors and equity security holders and general partners who previously accepted the Debtor's Amended Plan of Reorganization.

34. The provisions of the Plan relating to the Sharon Plan Loan fully comply with 11 U.S.C. § 364(d).

WHEREFORE, it is this 9th day of December, 1988, by the United States Bankruptcy Court for the District of Maryland,

ORDERED, that the Debtor's Third Amended Plan of Reorganization, filed on October 21, 1988, is hereby confirmed; and it is further

ORDERED, that the following technical amendments are hereby made to the Plan: (a) the date referred to at the end of Paragraph 4.1 of the Agreement for Plan of Reorganization is hereby corrected to be April 5, 1988; (b) Paragraph 3.15(c) of the Plan is hereby amended so that any and all capital contributions to be made by Historic under Section 3.15 of the Plan shall be made on or before the thirtieth day after this Order becomes final (within the meaning of Paragraph 1.9 of the Plan); (c) Paragraph 3.12(b) of the Plan is hereby amended so that the option referred to in said Paragraph 3.12(b) shall expire sixty-five (65) days after this Order becomes final (within the meaning of Paragraph 1.9 of the Plan); and (d) Paragraph 1.9(c) of the Plan (which defines when this Order shall be deemed final) is hereby deleted and replaced by the following: "(c) an appeal has been timely filed but the effect of the Order of confirmation has not been stayed within the time for filing the notice of appeal;" and it is further

ORDERED, that the objections to confirmation filed by Quality and Historic/ISI are hereby denied; and it is further

ORDERED, that the various objections to claims for purposes of voting on the Plan, and motions to allow such claims for purposes of voting, which were filed by the parties to this confirmation proceeding, are hereby dismissed for mootness, as the Plan meets all of the requirements for confirmation regardless of whether the claims

at issue are allowed or disallowed for the purposes of voting; and it is further

ORDERED, that this Court shall retain jurisdiction over this case as provided in Article X of the Plan; and it is further

ORDERED, that, except as otherwise provided in the Plan, the Debtor hereby is discharged from any and all debts that arose before the date of this Order, as set forth in 11 U.S.C. § 1141(d), and, except as otherwise provided in the Plan, all rights and interest of equity security holders, limited partners, and general partners are hereby terminated; and it is further

ORDERED, that the Agreement for Plan of Reorganization is hereby approved, and the FDIC's Class 4 secured claim is hereby allowed in accordance with Paragraph 2 of that Agreement and 11 U.S.C. § 1123(b)(3)(A); and its further

ORDERED, that the Debtor and its agents and employees are hereby authorized to issue, execute and deliver such documents and instruments, and to take such actions, as may be necessary to effectuate the Plan, the Agreement for Plan of Reorganization, and the Sharon Plan Loan; and it is further

ORDERED that, pursuant to 11 U.S.C. § 364(d)(1), the Debtor be and hereby is authorized to borrow $2,150,000.00 from Sharon Savings Bank, FSB, secured by a lien on the Property equal in priority to the lien on the Property held by the FDIC, upon the terms set forth in the Debtor's Third Amended Plan of Reorganization; and it is further

ORDERED, that all property of the estate is hereby vested in the Debtor pursuant to 11 U.S.C. § 1141(b), and such property is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the Debtor, except as otherwise provided in the Plan.

/s/ James F. Schneider
U.S. Bankruptcy Judge

cc: Irving E. Walker, Esquire
Frank, Bernstein, Conway & Goldman
300 East Lombard Street
Baltimore, Maryland 21202

David F. Albright, Esquire,
Richard M. Kremen, Esquire,
and Katharine M. Ebersberger, Esquire,
Semmes, Bowen & Semmes
250 W. Pratt Street
Baltimore, MD 21201

Stephen F. Fruin, Esq.
Melnicove, Kaufman, Weiner, Smouse & Garbis, P.A.
36 S. Charles Street
Suite 600
Baltimore, MD 21201

William A. McDaniel, Jr., Esq.
Robert Shaffer, Esq.
Murphy & McDaniel
118 W. Mulberry Street
Baltimore, MD 21201

Mr. Thomas Goetzinger
City Hall—Room 454
100 N. Holliday Street
Baltimore, MD 21202

Paul Nussbaum, Esq.
Whiteford, Taylor, Preston
Suite 1400
Seven St. Paul Street
Baltimore, MD 21202-1626

Edmund Goldberg, Esq.
Office of the U.S. Trustee
Room G-13, Fallon Building
31 Hopkins Plaza
Baltimore, MD 21201

Mr. Roger Gray
Smith, Burke and Azzam
326 North Charles Street
Baltimore, Maryland 21201

Roger K. Garfink, Esquire
Weinberg & Green
100 S. Charles St.
Baltimore, MD 21201

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

July 26, 1990

TO: Irving Edward Walker, Esq.
Diana Gribbon Motz, Esq.
Paul M. Nussbaum, Esq.
David Foxwell Albright, Esq.
Richard Marc Kremen, Esq.
Katharine Marie Ebersberger, Esq.

NOTICE OF JUDGMENT

Judgment was entered this date in Case Number(s):

89-2443
89-2444
89-2445

The Court's opinion is enclosed.

(2)

No. 90-664

In the Supreme Court of the United States

OCTOBER TERM, 1990

QUALITY INNS INTERNATIONAL, INC., ET AL., PETITIONERS

v.

L.B.H. ASSOCIATES LIMITED PARTNERSHIP AND FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

ALFRED J.T. BYRNE
General Counsel

ANN S. DUROSS
Assistant General Counsel

COLLEEN B. BOMBARDIER
Senior Counsel

GREGORY E. GORE
Counsel
Federal Deposit Insurance Corporation
Washington, D.C. 20429

QUESTION PRESENTED

Whether the debtor's plan of reorganization under Chapter 11 of the Bankruptcy Code satisfied the absolute priority rule when petitioners' unsecured interests were not paid in full, but the debtor's general partners who retained their partnership interests were required to reduce their senior secured claims or to make an equivalent cash contribution.

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QUALITY INNS INTERNATIONAL, INC., ET AL., PETITIONERS

v.

L.B.H. ASSOCIATES LIMITED PARTNERSHIP AND FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is not reported. The opinions of the district court and the bankruptcy court (Pet. App. 17a-65a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 26, 1990. The petition for a writ of certiorari was filed on October 23, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. L.B.H. Associates Limited Partnership (L.B.H.) filed a petition for reorganization under Chapter 11 in the United

States Bankruptcy Court for the District of Maryland. The sole asset owned by L.B.H. was the Lord Baltimore Hotel, which was operated by petitioners under a Management Contract and Franchise Agreement (Agreement). In connection with the bankruptcy, L.B.H. moved to terminate the Agreement with petitioners. L.B.H. also filed several plans for reorganization. The bankruptcy court confirmed the third such plan, over petitioners' objections. Pet. App. 3a-4a, 45a, 49a, 54a-55a, 61a.[1]

L.B.H.'s reorganization plan divides creditors' claims into several classes. Class 7 consists of the secured claims of L.B.H.'s general partners. Class 10 consists of the unsecured claims of petitioners. Class 14 consists of claims representing the partnership interests owned by L.B.H.'s general partners. Under the plan, L.B.H.'s general partners may retain their partnership interests in Class 14 in exchange for the partners' reduction of their Class 7 claims by $262,500, their provision of a contribution in cash in that amount, or their provision of any combination of cash and reduction of Class 7 claims totalling that amount. Petitioners objected to this aspect of the plan, contending that it violates the "absolute priority rule." Pet. App. 8a-9a, 33a.

The absolute priority rule as embodied in the Bankruptcy Code provides that with respect to dissenting unsecured claims that are impaired by the plan of reorganization, a plan shall not be approved unless it is "fair and equitable," a condition that includes the requirement that

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

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[1] The FDIC participated in the reorganization proceedings because it holds mortgages or liens on property of the Lord Baltimore Hotel. Pet. App. 28a-29a, 57a.

> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. 1129(b)(2)(B)(i) and (ii). In essence, a plan that diminishes the value of senior creditors' unsecured claims may not be "crammed down" over their objections unless the plan eliminates the interests of junior creditors. Petitioners argued that L.B.H.'s plan improperly permits the general partners to retain interests that are junior to petitioners', while petitioners' claims were not being paid in full. The bankruptcy court rejected that argument, finding that the general partners "will not receive or retain under the Plan any property on account of such junior claim or interest." Pet. App. 57a.

2. The district court likewise disagreed with petitioners' objection based on the absolute priority rule, and it affirmed the bankruptcy court's confirmation of the plan. Pet. App. 17a-37a. Although agreeing with petitioners that their claims were not being paid in full while the general partners were being allowed to retain their partnership interests, the court believed that the plan satisfied an exception to the absolute priority rule. The court explained that petitioners had failed "to take into account that in order to retain these interests the general partners must pay cash or give up the equivalent in secured claims." Consequently, the general partners were "required to put in new money or money value into the estate for the benefit of other creditors." *Id.* at 33a. The court rejected petitioners' argument that the contribution made by the general partners here was analogous to the "sweat equity" contribution that this Court found insufficient in *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988), to justify allowing the owners of a bankrupt enterprise to retain an interest in the enterprise despite creditors' objections. Pet. App. 33a.

3. The court of appeals affirmed in an unpublished, per curiam decision. Pet. App. 1a-16a. Although petitioners raised six issues on appeal, they did not question the concept that owners who contribute "new money" may retain their interests under an exception to the absolute priority rule. Rather, petitioners objected to the general partners' retention of their interests solely on the theory that the particular contribution required in this case did not constitute "a contribution of new money or money's worth within the exception to the absolute priority rule." Pet. C.A. Br. 27-28; Pet. C.A. Reply Br. 11-13.

The court of appeals rejected that contention, explaining that the general partners received their partnership interests in exchange for a capital contribution of $262,500, consisting of any combination of cash and reduction of the Class 7 claims. Pet. App. 9a. The $262,500 contribution, the court thought, validated the partners' retention of their interests because it constituted "a current contribution of 'money or money's worth,'" *ibid.* (citing *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 121-122 (1939)), and because the contribution was "necessary" to the success of the reorganization. Pet. App. 9a (citing "projected cash flow statements").

ARGUMENT

Petitioners contend (Pet. 4-9) that, on the particular facts of this case, the court of appeals misapplied the doctrine that the contribution of "money or money's worth" may permit the owners of a bankrupt enterprise to retain their interests despite the objection of senior creditors whose claims are not paid in full. The court's rejection of that factbound contention, announced in its unpublished decision, raises no issue worthy of this Court's review.

1. The absolute priority rule expresses the policy that dissenting, unsecured creditors must be paid in full before a junior interest can receive or retain property by virtue of

a plan of reorganization. *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988). The requirements of the absolute priority rule are now embodied in Chapter 11 of the Bankruptcy Code, enacted in 1978. 11 U.S.C. 1129(b)(2)(B)(ii). Before the enactment of the Code, this Court suggested that an exception to the absolute priority rule would exist when the owners of the bankrupt enterprise make a contribution of "money or money's worth, reasonably equivalent in view of all the circumstances to [their] participation," and when equity holder participation is necessary to gain the infusion of new capital into the enterprise. *Case* v. *Los Angeles Lumber Products, Co.*, 308 U.S. 106, 117, 121-122 (1939) (dicta). In such a case, the Court explained, the equity holder may participate in the reorganized enterprise even though the claims of creditors are not fully honored and those creditors do not consent to such participation.

In *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988), this Court assumed, without deciding, that the exception described in *Los Angeles Lumber* survived the enactment of the Bankruptcy Code, but the Court went on to hold that it did not apply to an owner's commitment to contribute "labor, experience, and expertise" in running the enterprise under reorganization. *Id.* at 203 & n.3. The Court explained that those forms of contribution were inadequate to satisfy the new-value exception to the absolute priority rule discussed in *Los Angeles Lumber* because the "promise of future services is intangible, inalienable, and, in all likelihood, unenforceable." 485 U.S. at 204. Rather than constituting an infusion of capital that immediately enhances the enterprise's value, "a promise of future services cannot be exchanged in any market for something of value to the creditors *today*." *Ibid.*

Petitioners rely (Pet. 6-7) on *Norwest Bank Worthington* in arguing that the "particular plan" approved in this case

does not involve an infusion of new capital into the debtor. Petitioners do not contend that the cash contribution contemplated as one option under the plan would not be "money or money's worth" for purposes of the *Los Angeles Lumber* exception. Rather, they argue that the option for the owners to cancel their secured claims is not new value that allows them to retain their equity interests.

But the forgiveness of a higher priority debt may constitute "money's worth" within the meaning of the *Los Angeles Lumber* exception. As the court explained in *In re Future Energy Corp.*, 83 Bankr. 470, 498 (Bankr. S.D. Ohio 1988), "if the transaction in question both benefits the debtor and places the shareholder in a position of economic risk, a capital contribution within the meaning of [*Los Angeles Lumber*] and its progeny shall be deemed to have been made." *Future Energy Corp.* held that the forgiveness of secured debt benefits the debtor and imposes economic risk on the owner, thus satisfying the requirements of a capital contribution for purposes of the "money's worth" exception. 83 Bankr. at 498. The same analysis applies here. The general partners of L.B.H. were given the option of relinquishing secured claims, senior to petitioners' claims, as a condition of retaining their ownership interests. By cancelling their security interests and accompanying claims on the debtor's assets, the general partners contributed "money or money's worth" to the debtor just as surely as if they had paid money into the debtor's estate for it to use in extinguishing the secured debt.

The surrender of secured debt here bears scant resemblance to the promise of future services found wanting in *Norwest Bank Worthington* v. *Ahlers*. In that case, the owners of the enterprise were essentially offering nothing but their willingness to continue working towards the success of the venture under reorganization. Such an interest cannot be translated into a quantifiable benefit to the

creditors of the enterprise; as the Court explained, it is not an asset that can be booked on the entity's balance sheet. 485 U.S. at 204. But the forgiveness of higher-priority secured debt immediately frees up an asset for inclusion on the entity's books, because it removes the lienholders' interest in the property in question. Where, as here, "these contributions are necessary to the success of the undertaking," Pet. App. 9a, they satisfy the exception to the absolute priority rule as delineated by *Los Angeles Lumber*.[2]

2. A more important issue – not raised by petitioners – is whether the *Los Angeles Lumber* exception to the absolute priority rule survives the enactment of the Bankruptcy Code. In *Norwest Bank Worthington* v. *Ahlers*, we argued that this "money or money's worth" exception was eliminated by the Bankruptcy Code. This Court concluded that the exception did not apply on the facts of that case, and left for another day the issue of "the continuing vitality of the *Los Angeles Lumber* exception." 485 U.S. at 203 n.3. We continue to believe that the Bankruptcy Code abolished the "money or money's worth" exception, but, for three reasons, we do not believe that that issue warrants review here.

First, petitioners have never raised the question of *whether* a "money or money's worth" exception exists, as opposed to *how* it applies in this case. The thrust of petitioners' argument has been to acknowledge the validity of the exception, but then quarrel about its dimensions and requirements. See

[2] Although petitioners assert (Pet. 9) a need for this Court's guidance on the implications of the *Los Angeles Lumber* exception, only two cases of which we are aware have involved the question of whether the cancellation of secured debt satisfies that exception – this decision and *Future Energy Corp.* We see no need for the Court to clarify the scope of *Los Angeles Lumber* in such a comparatively unusual setting, where no conflict of authority is even alleged to exist.

Pet. C.A. Br. 27-28; Pet. C.A. Reply Br. 11-13.[3] Accordingly, the court of appeals was given no reason to consider the deeper issue of whether the Bankruptcy Code changed the legal context in which the absolute priority rule operates, with the effect of rejecting the dicta in *Los Angeles Lumber*. Understandably, the Fourth Circuit's per curiam opinion does not allude to that issue.

Nor does the petition present the question of whether the "money or money's worth" exception enjoys continuing validity. Rather, the petition assumes that the exception is valid, and then goes on to discuss its contours and rationale. Pet. 6. In light of petitioners' failure to challenge the existence of the exception, this Court may deem that contention waived. The "general rule" is that "a federal appellate court does not consider an issue not passed upon below," *Singleton* v. *Wulff*, 428 U.S. 106, 120 (1976), and there is nothing exceptional about this case that warrants departure from that principle. See *Hormel* v. *Helvering*, 312 U.S. 552, 557 (1941).

Second, the courts of appeals have had comparatively few opportunities to consider the issue left open in *Norwest Bank Worthington*, and it has as yet generated no conflict in the circuits.[4] One court of appeals recently urged the view that the *Los Angeles Lumber* exception does not survive the Code, but the court "stop[ped] short" of deciding that question because it concluded that the value contributed in that case did not satisfy the "money or money's worth" require-

[3] The FDIC, represented by outside counsel without the participation of the Department of Justice, confronted petitioners' arguments on their own terms, and did not raise the question of whether the *Los Angeles Lumber* exception survived the enactment of the Bankruptcy Code.

[4] As the Court noted in *Norwest Bank Worthington*, bankruptcy judges have been divided on the issue for some time. 485 U.S. at 203-204 n.3.

ment as expressed in *Norwest Bank Worthington. Kham & Nate's Shoes No. 2, Inc.* v. *First Bank of Whiting*, 908 F.2d 1351, 1359-1363 (7th Cir. 1990); see also *In re Stegall*, 865 F.2d 140, 142-144 (7th Cir. 1989). Other circuits, like the Fourth Circuit here, have apparently not focused on the question. See, *e.g*, *In re Blankemeyer*, 861 F.2d 192, 194 (8th Cir. 1988) (finding owner's proposed contribution inadequate to justify retention of ownership interest without questioning the validity of *Los Angeles Lumber*). Although we believe that this Court should review the validity of that exception in an appropriate case, absent a conflict in the circuits we see no pressing need to do so here.

Third, although it is our view that the exception to the absolute priority rule applied by the court of appeals is not a valid one, we do not suggest that the Court remand the case for further consideration of that issue. Because the Fourth Circuit's unpublished decision establishes no precedent, the opinion below will not hinder reconsideration of the "money's worth" exception when a dissenting creditor actually chooses to litigate that issue, as petitioners did not. And, as a prudential matter, it is quite late in the day to unravel the reorganization plan adopted in this case.[5]

Litigation by petitioners challenging the reorganization has been protracted and vigorous. As the district court ruefully observed, objections (by petitioners and others) proliferated "because there seems to have been a scorched earth policy in the litigation of this case." Pet. App. 19a. Petitioners have resisted the bankruptcy court's effort to make the Lord Baltimore Hotel function again as a viable economic entity, through numerous appeals, raising

[5] The bankruptcy judge observed that "[a]ll of us have invested parts of our lives in this case. I will always remember 1988 as the year of the Lord Baltimore case." Pet. App. 50a.

numerous issues. In a careful opinion, the court of appeals rejected each of the many claims that petitioners urged upon it, as had the district court before it. At this juncture, the settled expectations of the parties, and the long efforts devoted to making the reorganization a success, weigh against reversing the judgment for consideration of a legal issue that petitioners have never elected to assert.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

ALFRED J.T. BYRNE
General Counsel

ANN S. DUROSS
Assistant General Counsel

COLLEEN B. BOMBARDIER
Senior Counsel

GREGORY E. GORE
Counsel
Federal Deposit Insurance Corporation

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No. 90-664

IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

QUALITY INNS INTERNATIONAL, INC., *et al.*,
Petitioners

v.

L.B.H. ASSOCIATES LIMITED PARTNERSHIP and
FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondents

**On Petition for Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

PETITIONERS' REPLY TO THE BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

DAVID F. ALBRIGHT *
FRANKLIN T. CAUDILL
SEMMES, BOWEN & SEMMES
250 West Pratt Street
Baltimore, Maryland 21201
(301) 539-5040
Counsel for Petitioners

* Counsel of Record

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PETITIONERS' REPLY TO THE BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

ARGUMENT

In its Brief in Opposition, the Federal Respondent raises three points. First, an attempt is made to show that the present case does in fact satisfy the alleged "money or money's worth" exception to the Absolute Priority Rule. Second, the Federal Respondent claims that the issues raised by the Petition do not warrant review on a Writ of Certiorari. Third, an argument is advanced that a remand of this matter would be imprac-

tical at the present time. None of these contentions has the slightest validity, and none of them warrants more than a brief discussion.

Clearly, the Federal Respondent's consideration of the alleged "money or money's worth" exception is fatally flawed by its misdescription of the relative seniority of the claims in question. According to the Brief in Opposition, the claims of the Debtor's principals were "high priority debt", "senior to petitioners' claims", and "higher-priority secured debt". *See* Brief in Opposition, at 6-7.

In advancing this argument, the Federal Respondent simply ignores the fact that the partnership interests of the Debtor's principals (which were retained under the Plan) are concededly junior to the Petitioners' claims. This fact was recognized by the District Court, which stated as follows:

> I would note that the class 7 claims are secured claims by definition. These general partnership interests are junior to the Quality unsecured claims which, under the plan, are not being paid in full. [Appendix, at 33a]

Indeed, the Court of Appeals also acknowledged the junior status of the interests of the Debtor's principals. [Appendix, at 9a]

Inexplicably, as outlined in the Petition for Writ of Certiorari, the courts below failed to apply the Absolute Priority Rule and allowed the principals' junior interests to survive despite the obvious impairment of Petitioners' senior claims. Instead of supporting the lower courts' erroneous legal conclusions, the Brief in Opposition compounds the error by misrepresenting the priorities of the parties' claims. Such confusion of the record is of little service to the Court in resolving this important issue. In reality, the errors in the Brief in Opposition merely

serve to underscore the unusual nature of the holdings below, which impaired senior claims in order to preserve junior claims, in clear violation of the Absolute Priority Rule.

Second, the Federal Respondents' contentions as to the desirability of reviewing these issues simply do not pass muster. The Brief in Opposition admits that, in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the Federal Respondent took the opposite view and urged this Court to apply the Absolute Priority Rule strictly and without exceptions. *See* Brief in Opposition, at 7. The Federal Respondent also recognizes that the Court of Appeals in this case improperly applied the Absolute Priority Rule. *Id.* at 9. Moreover, the Federal Respondent presents further clear evidence of the conflicts among the Circuits on the strictness with which the Absolute Priority Rule should be applied. *Compare Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1352 (7th Cir. 1990) (no exceptions to Absolute Priority Rule) with *In re Blankemeyer*, 861 F.2d 192 (8th Cir. 1988) (recognizing exceptions), both cited in Brief in Opposition, at 9.

Accordingly, this case concededly displays the factors which this Court regards as significant in granting review. These include the importance of the issue, conflicting decisions in the lower courts, and an erroneous decision by the Court of Appeals in this case justifying the exercise of the Supreme Court's power of supervision. *Compare* Rule 10, Rules of the Supreme Court of the United States. Therefore, in addition to the factors discussed at length in the Petition for Writ of Certiorari, one need look no further than the Brief in Opposition itself to justify issuance of a Writ of Certiorari.[1]

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[1] Only a footnote reference is needed for the contention that Petitioners waived their arguments below. The opinions of the lower courts (App. 8a & 33a) are clear evidence to the contrary.

Finally, the Federal Respondent suggests that, as a practical matter, it is too late to "unravel" the Plan in this case. *See* Brief in Opposition, at 9. No reason is given for this highly generalized assertion. There is no evidence, for instance, that the Debtor's wealthy principals would be unable to provide an actual infusion of cash, if they were required to do so. In any event, the Federal Respondent provides no basis for a finding that the Debtor's plan would "unravel" if the principals were to observe the Absolute Priority Rule as required by law.

CONCLUSION

This Petition raises serious issues which have already divided the lower courts and which will continue to arise in today's economic climate as the principals of failed business enterprises attempt to retain control of those enterprises. This Court should provide a clear directive as to the conditions under which such principals will be allowed to retain their power. In particular, this Court should strictly construe the Absolute Priority Rule and determine that, if any exception is to be allowed at all, only the infusion of new capital will justify the principals' continued control. The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

DAVID F. ALBRIGHT *
FRANKLIN T. CAUDILL
SEMMES, BOWEN & SEMMES
250 West Pratt Street
Baltimore, Maryland 21201
(301) 539-5040
Counsel for Petitioners

* Counsel of Record